BANKS IN REAL ESTATE: A REVIEW OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY'S DECEMBER 2005 RULINGS

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, FINANCE, AND ACCOUNTABILITY

OF THE

COMMITTEE ON GOVERNMENT REFORM

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WEDNESDAY, SEPTEMBER 27, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
FINANCE, AND ACCOUNTABILITY,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:30 p.m. in room 2247, Rayburn House Office Building, Hon. Todd Russell Platts (chairman of the subcommittee) presiding.

Present: Representatives Platts, Towns, Kanjorski, and Davis of Virginia.

Staff present: Mike Hettinger, staff director; Tabatha Mueller, professional staff member; Seth Lennon, clerk; Adam Bordes, minority professional staff member; and Teresa Coufal, minority assistant clerk.

Mr. PLATTS. The Subcommittee on Government Management, Finance, and Accountability will come to order.

In December 2005, the Office of the Comptroller of the Currency issued three interpretive letters allowing certain banks to invest in real estate projects. According to the OCC, these rulings are consistent with past precedent and with the National Bank Act, which allowed banks to invest in these types of projects as long as they are necessary to accommodate the bank's business activities. The rulings, however, have sparked controversy in and around the real estate industry, which views these actions as a significant departure from what has been previously permitted.

Without going into too much detail, the interpretive letters were issued to PNC Bank to develop a project involving retail, office, a hotel and 32 condominiums on property it owns next to its Pittsburgh headquarters, to Bank of America to develop a Ritz Carlton hotel adjacent to its headquarters in Charlotte, and to Union Bank of California to finance the development of a windmill farm and associated real estate.

At issue today is whether the OCC process that allowed for these letters is consistent and transparent as well as whether or not the letters themselves represent a departure from past precedent and begin to blur the line between banking and commerce that Congress has stridently tried to maintain.

We are pleased to have to panels of distinguished witnesses with us today. Our first panel is Ms. Julie Williams, First Senior Deputy

Comptroller and Chief Counsel with the OCC. Our second panel will include Mr. Thomas Stevens, president of the National Association of Realtors, Mr. Edward Yingling, president and CEO of the American Bankers Association, and Ms. Cynthia Shelton, a commercial real estate broker at Colliers Arnold of Orlando, FL, representing the Realtors Commercial Alliance.

We certainly thank all of our witnesses for being here today and look forward to your testimonies. I now yield to our ranking member, the gentleman from New York, Mr. Towns, for the purposes of an opening statement.

Mr. TOWNS. Thank you very much, Mr. Chairman.

I am looking forward, first of all, to the testimony coming from our witnesses.

Since the passage of the National Bank Act in 1963, the Federal Government has consistently applied laws maintaining a firewall between commercial activity and national banks. By doing so, we have successfully insulated our banking system from past economic recession and shocks that have caused significant losses for private industry, particularly within the real estate sector. Recent decisions by the OCC, however, have created potential loopholes for banks to manage and develop real estate holdings. I believe this goes beyond what is provided for under current law, and fear that relaxing prior standards will expose our financial system and Government insurance programs to excessive economic risk.

In response, I have co-sponsored H.R. 111, the Community Choice in Real Estate Act, which would prohibit banks entering the real estate brokerage or management market. I am hoping, however, that proposed legislation will get the OCC and private industry to begin a dialog that will both strengthen current limitations and establish specific guidance for where exceptions to the rules should be made. I hope today's hearing will serve as a basic for that dialog. Hopefully we will be able to ascertain some information that will assist us in making certain that we are making the appropriate decision.

Thank you very much, Mr. Chairman, and on that note, I yield back.

Mr. PLATTS. Thank you, Mr. Towns. We will move to our first panel.

Ms. Williams, thank you very much for being with us. The practice of the subcommittee is to swear in all of our witnesses. So if I could ask you to stand and raise your right hand.

[Witness sworn.]

Mr. PLATTS. Thank you, Ms. Williams. The Clerk will note that the witness affirmed the oath.

We appreciate the written testimony, or as I call it, my homework, being provided to us in advance. We look forward to your oral testimony. We will give you 5 minutes on the clock. If you need to go over some, we understand that. We look forward to then a Q&A following your testimony.

Ms. Williams, the floor is yours.

STATEMENT OF JULIE L. WILLIAMS, FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Ms. WILLIAMS. Thank you very much, Chairman Platts, and Ranking Member Towns. On behalf of the Office of the Comptroller of the Currency, I do appreciate the opportunity to appear before you today to discuss the three interpretive letters issued by the OCC in December 2005.

As I described in detail in my written statement, the decisions reflected in these letters are entirely consistent with the National Bank Act, and they are well within the principles of existing precedent for national banks' activities. The legal framework that is applicable in this area is narrow and it is fact-dependent. The conclusions in these letters therefore simply cannot pave the way for the sort of expanded real estate activities that some have projected.

The conclusions in the letters are quite specific to the activities described and they are limited in scope. They apply existing law and precedent to situations that involve some new factors. They authorize no more than the specific proposals that they describe, and only for the particular banks involved. Thus, the letters to not endanger the fundamental separation of banking and commerce in this country.

The letters do not authorize national banks to engage in the real estate development or investment business, nor do they have anything to do with merchant banking, nor do they have anything to do with allowing national banks to conduct a real estate brokerage business. They also were carefully evaluated by OCC supervisors to assure that the activities would be consistent with safe and sound operations of the banks involved. Moreover, going forward, the OCC will continue to monitor these activities to ensure that they are conducted in a safe and sound manner and that they are conducted consistent with the representations made to us by each of the banks.

Two of the letters concern situations where national banks seen to enhance the use of property they already own in connection with operational needs of their own banking business. Each letter permitted only a single building. In each case, we found that the bank demonstrated that the proposed building was being developed in good faith to address legitimate operational needs of the bank's own banking business. This connection to a bank's own operational needs is essential to its legal authority to conduct these activities, and this linkage prevents national banks from conducting a real estate investment or development business.

In one case, the building in question would be a mixed-use building with offices, hotel space and upper floor space that would be sold off, sold off in the form of condominiums. In that case, the bank would occupy a portion of the offices and committed to use a percentage of the hotel rooms for bank officials and bank visitors.

In the second case, the building would be used entirely as a hotel. The bank represented that visiting bank officials, board members, customers and prospective customers and service providers would occupy over 37 percent of the rooms which constituted over 50 percent of the projected occupied rooms.

The third letter concluded that a bank could provide financing to a wind energy project in the form of payment for an equity interest in a limited liability company, in order for the bank to be eligible for Federal tax credits and thereby lower the cost of funding for the project. It was important to us in reaching our conclusion that facilitating such financing is precisely Congress' purpose in creating such tax credits.

A number of specific restrictions and limitations were included in the letter to make clear that our approval was based on the bank's interest being structured to preserve its economic substance as a loan rather than a speculative investment.

This approach was based on decades of judicial and OCC precedent which looked to the economic substance of the transaction rather than only its form, to determine whether it is permissible. Leasing arrangements, found to be permissible because they are functionally interchangeable with a secured loan, are a long-recognized example of this approach. Let me again stress that by statute, national banks have only limited authority to make real estate and equity investments. This limited authority precludes national banks from engaging in the real estate development business or the type of equity investment activity that would breach the separation between banking and commerce.

However, this same authority does enable national banks to take different types of direct and indirect interest in real estate in connection with conducting their own banking business. Over the past century, both the courts and the OCC have interpreted this limited authority to permit or prohibit particular types of activities based on particular facts. This limited authority helps to maintain the fundamental separation of banking and commerce that distinguishes our Nation's banking system.

Please be assured that the OCC fully recognizes these limits of national banks' authority with respect to real estate activities and will abide by and apply those standards consistently to all national banks.

I thank you for the opportunity to appear before you today and I would be happy to try and answer any questions you may have.

[The prepared statement of Ms. Williams follows:]

For Release Upon Delivery
2:00 p.m. September 27, 2006

TESTIMONY OF

JULIE L. WILLIAMS

FIRST SENIOR DEPUTY COMPTROLLER

AND CHIEF COUNSEL

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,

FINANCE, AND ACCOUNTABILITY

Of the

COMMITTEE ON GOVERNMENT REFORM

UNITED STATES HOUSE OF REPRESENTATIVES

September 27, 2006

Statement required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I. INTRODUCTION

Chairman Platts, Ranking Member Towns, and members of the Subcommittee, I appreciate this opportunity to appear before you today on behalf of the Office of the Comptroller of the Currency (OCC) to discuss the three interpretive letters issued by the OCC in December 2005, which you have asked the OCC to address. Two of the letters to which you refer concern situations where banks seek to enhance use of property that they already own, in connection with their own banking operations. The third letter relates to a bank's provision of financing to an energy project. It appears that in many respects the scope and application of these letters has been misunderstood, and thus I welcome the opportunity to describe them – and their impact – fully, here today.

The decisions reflected in the letters are within the OCC's authority and provisions of the National Bank Act. As I will describe in more detail below, the conclusions contained in the letters are quite specific, limited in scope, and within the framework of existing precedent for national banks' activities. Since many claims have been made about what the letters do and do not authorize, let me be very clear that they do not breach the boundaries between banking and commerce, do not authorize national banks to engage in the business of real estate investment or development, have nothing to do with merchant banking, have nothing to do with allowing national banks to conduct real estate brokerage, and were carefully evaluated by OCC supervisors to assure that the activities would be consistent with the safe and sound operations of the banks involved.

Because of the limited and specific nature of the activities addressed in the letters, the banks involved do not have dual roles that could present conflicts of interest, nor do the letters set new precedent that will lead to greater participation by national banks in real estate that could potentially have larger effects on the economy. Because the OCC reviews all such proposals on

a case-by-case basis, and because our review includes participation by the supervisory officials for each bank, the conclusions in the respective letters are applicable only to the particular bank at issue. We have no evidence that the issuance of the letters has resulted in an increase in national banks seeking to engage in real estate related activities; in fact, since the letters were issued, we have received no proposals from other national banks seeking to rely on them for their own activities.[1] Please be assured that the OCC fully recognizes the limits of national banks' authority with respect to real estate activities and will apply those standards consistently to all national banks.

II. DISCUSSION OF THE THREE LETTERS

The limited authority of national banks to invest in real estate has long been recognized by both the courts and the OCC. This authority enables national banks to take different types of direct and indirect interests in real estate in connection with conducting their own banking business.

The following discussion describes in detail the factors the OCC relied on in reaching its decisions on the letters at issue, why the letters are consistent with the agency's authority and supported by the National Bank Act, and why they are fully consistent with the well-recognized—and limited—parameters for national banks' acquisition of interests in real estate.

A. Real estate/premises letters

Two of the letters, which I will call the "Bank Premises Letters," permitted the banks to develop property they already owned, in ways that enhanced how the property served each

[1] Because conclusions in the letters are expressly conditioned on the specific facts presented and the capacity of the respective banks to conduct the activities in question, the letters do not generally authorize other national banks – or state banks – to engage in comparable activities. The authority of state banks to invest in real estate or engage in real estate related activities such as real estate brokerage is, in many cases, broader than the authority of national banks.

bank's banking operations. The letters are based upon decades-old judicial precedent and OCC interpretations that expressly recognize that a national bank may hold and develop property used in connection with its own operations and lease or sell the portion of the premises that the bank does not use. This authority is subject to substantial limitations and constraints, including the requirement that the development must not be speculative or motivated by realizing a gain on appreciation of the real estate property value. In each letter, based on specific information provided by each bank, the OCC concluded that the bank demonstrated that the proposed bank premises development was justified by a legitimate and good faith business need for accommodation of the bank's business activities. As a result, the Bank Premises Letters have a limited and specific impact and do not lay a foundation for national banks' engaging in the real estate development (or brokerage) business, and they do not breach the separation of banking and commerce.

It is useful to review the details of the two letters, since they demonstrate that the scope and implications of the letters are very limited indeed.

The situation addressed in the first letter (Interpretive Letter 1044), involved a proposal to establish a mixed-use office, hotel, and residence building on the property already owned by the bank. The proposal would expand the bank's corporate headquarters complex, which the bank currently occupies to nearly full capacity, enabling the bank to relocate staff from more distant leased space, giving the bank additional office space for future expansion, and providing space for bank staff displaced by renovation of another of the bank's buildings. The bank represented that it would occupy at least 22% of the premises of the new building. It also explained that the proposed mixed-use nature of the premises was necessary for the new building to be a viable project. The bank also presented evidence that the proposal represented an important part of an economic rejuvenation effort for downtown Pittsburgh, since the new premises—with their

specific combination of office, hotel and residential space[2]—would be replacing rundown, dilapidated buildings that currently occupy the lots to be developed.

The second letter (Interpretive Letter 1045), addressed the establishment of a hotel facility, also on property already owned by the bank and also adjacent to the bank's corporate headquarters in downtown Charlotte. The bank represented that it would use more than 50% of the occupied rooms to lodge out-of-area bank employees, bank directors, vendors, shareholders, customers and others who were visitors on bank-related business. The provision of lodging for out-of-area visitors and doing so in a convenient and cost-effective manner provided legitimate business reasons for the proposal. The bank also supported this proposal as an enhancement to the downtown area, anticipating that the hotel, to be built on a site currently used as a parking lot, would contribute to new businesses and new jobs at the site and in its vicinity.

Our conclusion in both cases was based on national banks' authority to acquire and develop bank premises under 12 U.S.C. § 29. That section provides that a national bank may purchase, hold, and convey such real estate "as shall be necessary for its accommodation in the transaction of its business."

In applying this standard, the courts and the OCC have recognized that bank premises can take different forms, such as office buildings, parking, storage, and, as here, lodging. The courts also have long recognized the principle that it is appropriate for a national bank to maximize the utility of its banking premises by leasing or selling the portion of the premises. For example, in *Brown v. Schleier*, 118 F. 981, 984 (8th Cir. 1902), *aff'd*, 194 U.S. 18 (1904), the court stated:

> If the land which [a national bank] purchases or leases for the accommodation of its business is very valuable, it should be accorded the same rights that belong to other landowners of improving it in a way that will yield the largest income, lessen its own

[2] The bank demonstrated that, in order to establish required office space in an economically feasible manner, it needed to sell off a small number of residential condominiums. The bank showed that residential condominiums are becoming a common addition to downtown mixed-use office construction and that the number of condominiums it proposed were readily marketable – by an unrelated real estate broker – thus the bank would not retain that portion of the property.

> rent, and render that part of its funds which are invested in realty most productive. There is nothing, we think, in the national bank act, when rightly construed, which precludes national banks, so long as they act in good faith, from pursuing the policy above outlined.

For decades—indeed, for over 100 years—courts have recognized *Brown* as one of the leading, if not the leading, case on the authority of national banks to establish and utilize bank premises.[3]

The *Brown* case also contains important limiting principles that have long been recognized by the OCC and the courts. The acquisition of real estate or establishment of bank facilities must be conducted in good faith in furtherance of a bank's banking operations, and not as a real estate development business. The burden is on the bank to demonstrate a legitimate business reason based on accommodating its *banking business operations* for acquiring and/or developing the property for the projected use. As one measure of good faith use of the premises for banking purposes, the courts and the OCC look to the percentage of use or occupancy of property in conjunction with the bank's business. Finally, the investment must not be speculative or motivated by realizing a gain on appreciation of the real estate property value. OCC interpretations, including these Bank Premises Letters, have recognized these substantial limitations and constraints.

The following chart summarizes precedent and OCC interpretations involving the sale or lease of excess bank premises. The percentage of bank occupancy or use generally has varied between 15% and 50%, with the excess space in the premises available for use by third-parties.

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[3] *See, e.g., Morris v. Third Nat'l Bank*, 142 F. 25, 32 (8'" Cir. 1905), *cert. denied*, 201 U.S. 649 (1906); *Wingert v. First Nat'l Bank*, 175 F. 739,741 (4'" Cir. 1909)) *appeal dismissed* 223 U.S. 670 (1912); *Second Nat'l Bank v. US. Fidelity & Guaranty Co.*, 266 F. 489, 493 (4'" Cir.), *appeal dismissed*, 254 U.S. 660 (1920); *Perth Amboy Nat'l Bank v. Brodsky*, 207 F. Supp 785, 788 (S.D.N.Y.1962) (citing *Brown* for the conclusion that "[i]t is clear beyond cavil that the statute permits a national bank to lease or construct a building, in good faith, for banking purposes, even though it intends to occupy only a part thereof and to rent out a large part of the building to others"); *Farmers' Deposit Nat'l Bank v. W'ern Penn. Fuel Co.*, 215 Pa. 115, 118(1906).

Judicial and OCC Precedents Addressing National Banks' Authority to Lease Excess Bank Premises to Third-Parties

Citation	Date	Holding	% Occupancy by National Bank (if applicable)
Interpretive Letter (available in Lexis-Nexis)	December 16, 1991	National bank may lease portion of storage facility on bank premises to unrelated third-party	50.0%
Interpretive Letter (available in Lexis-Nexis)	March 10, 1994	National bank may add space to two existing bank buildings and lease all new space to third-parties	40.0%
Interpretive Letter No. 1045	**December 5, 2005**	**National bank may establish hotel to provide lodging for out-of-area staff, customers, and vendors, and lease excess space to third-parties**	**37.5%**
Perth Amboy Nat'l Bank v. Brodsky, 207 F.Supp. 785 (S.D.N.Y. 1962)	August 6, 1902	Recognizing authority of national bank to use percentage of building for bank purposes and lease remainder to third-parties	30.0%
Conditional Approval No. 298	December 15, 1998	National bank may establish office complex and parking facilities to provide office space for bank employees	25.0%
Interpretive Letter No. 1044	**December 5, 2005**	**National bank may establish mixed-use building to provide office space for bank employees and to provide lodging for out-of-area staff, customers, and vendors, and lease excess space to third-parties**	**22.0%**
Interpretive Letter No. 1034	April 1, 2005	National bank may establish two office building complex to provide office space for bank employees, and lease excess space to third-parties	22.0%
Wirtz v. First Nat'l Bank & Trust Co., 365 F.2d 641 (10th Cir. 1966)	August 30, 1966	National bank may occupy percentage of office complex and lease remaining space to third-parties	20.7%
Wingert v. First Nat'l Bank, 175 F. 739 (4th Cir. 1909), *appeal dismissed*, 223 U.S. 670, 672 (1912)	December 16, 1909	National bank has authority to tear down bank building and construct new six story office building in which bank will occupy only first floor, and lease excess space to third-parties	16.7%
Interpretive Letter (unpublished)	January 29, 1981	National bank may occupy percentage of office complex and lease remaining space to third-parties	15.0%
Interpretive Letter (available in Lexis-Nexis)	July 24, 1987	National bank may occupy small percentage of new office building constructed adjacent to bank's headquarter's building, with potential future expansion into larger percentage of new building; excess space leased to third-parties	5.0%
Additional Bank Premises Precedent That Do Not Discuss a Specific Percentage Occupancy			
Brown v. Schleier, 118 F. 981 (8th Cir. 1902), *aff'd*, 194 U.S. 18 (1904)	November 10, 1902	National Bank Act does not preclude a national bank, acting in good faith, from maximizing the utility of its banking premises by leasing excess bank premises to third-parties	
Interpretive Letter No. 2	December 13, 1977	National bank may own apartment in Los Angeles for use by its CEO who maintains his primary residence elsewhere	
Interpretive Letter No. 274	December 2, 1983	National bank may lease lobby space to variety of third-parties	
Interpretive Letter (available in Lexis-Nexis)	August 14, 1985	National bank authorized to develop portion of new bank premises building as office condominiums and sell the condominiums	
Interpretive Letter (available in Lexis-Nexis)	June 24, 1992	National bank may purchase building to house its retail brokerage business, and lease building to third-party broker which will have dual employees with the bank	
Interpretive Letter No. 1042	January 21, 1993	National bank may hold condominium for use of out-of-area visitors	
Interpretive Letter (available in Lexis-Nexis)	May 6, 1993	National bank may accept contribution of real property for future bank premises from its holding company	
Interpretive Letter No. 630	May 11, 1993	National bank may license use of space on its premises to a third party	
Interpretive Letter No. 1043	July 8, 1993	National bank may lease condominium, used for out-of-area bank visitors, to third-parties when not in use by bank visitors	
Interpretive Letter (available in Lexis-Nexis)	September 13, 1993	Bank, if it were national bank, could retain ownership of residences used by executives of bank's foreign parent on lon-term rotations	
Interpretive Letter (available in Lexis-Nexis)	February 23, 1994	National bank may transfer vacant land it holds from OREO to future bank premises	
Interpretive Letter No. 758	April 5, 1996	National bank may lease portion of parkland, held as bank premises, to third-party	
Interpretive Letter (available in Lexis-Nexis)	August 18, 1997	National bank may dispose of unneeded leased bank premises by renewing its lease for 99 years and entering into coterminous sublease with developer	
Interpretive Letter	December 8, 2005	National bank may lease parcel larger than necessary in order to establish bank branch when lessor will lease only whole parcel; bank will sublease excess acreage to third-party	

As the chart demonstrates, the proposals addressed in the Bank Premises Letters involve occupancy percentages well within the range of both judicial precedent and other OCC interpretations.

Under the standards described above, we found the proposals in the Bank Premises Letters to be permissible. In each letter, the bank demonstrated a legitimate business reason based on the accommodation of its banking business operations for developing the property with the projected use. In each letter, the bank's represented level of occupancy established good faith development of bank premises in furtherance of the bank's banking operations. In neither letter was the development of bank premises predicated on a desire to speculate in real estate property values. Finally, each proposal was reviewed thoroughly from a supervisory perspective, and no safety and soundness concerns were found.

Finally, it is important to stress that neither of these letters has anything to do with national banks' engaging in the real estate *brokerage* business. The first Bank Premises letter, in fact, expressly noted that a real estate broker unrelated to the bank would be responsible for sales of the condominiums. This was one of the representations upon which the OCC relied in issuing this Interpretive Letter.

B. Project Financing Letter

The Project Financing Letter (Interpretive Letter 1048) involves the provision of financing to a wind energy project. The letter authorizes a bank to provide financing to a wind energy project in the form of an investment in order to allow the bank to take advantage of federal tax credits available for such projects, thereby lowering the overall financing cost of the project. The restrictions and limitations in the Project Financing Letter make clear that our

approval is premised on the bank's interest being structured so as to preserve its economic substance as a loan rather than a speculative equity investment. In particular, unlike a traditional equity investment, the bank (1) may not participate in the operation of the business receiving the bank's financing; (2) may not realize any gain on the appreciation of the value of its interest in the business or assets held by the business; and (3) must provide in the project agreement many of the same terms, conditions, and covenants typically found in lending and lease financing transactions to protect its interests.

A key factor in the decision to allow this financing transaction to be structured as an equity investment was to allow the bank to capture tax benefits that were enacted by Congress to finance alternative sources of energy. For similar reasons—that is, to capture tax benefits that Congress has authorized to promote certain types of projects—the OCC has long permitted national banks to provide financing that takes the form of equity, *e.g.*, to finance low-income housing, the renovation of historic buildings, and other types of community development projects. These transactions have proven to be low risk, and like the alternative energy financing here, provide an important source of capital to projects that Congress, by providing tax credits in connection with such investments, has affirmatively sought to promote.

Both the OCC and the courts have held that permissible loan-equivalent transactions can take different and non-traditional forms in order to accommodate the demands of the market; the economic substance of the transaction, rather than its form, guides the analysis of whether the transaction is a permissible lending activity. The leading case on this is *M & M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978) (national banks may acquire, own, and lease automobiles and heavy equipment; when the economic characteristics of a lease are substantially similar to a loan, the lease is deemed to be

an exercise of the bank's lending powers).

The Project Financing Letter noted its reliance on a 1994 precedent where the OCC found a transaction similar in structure to be a permissible loan notwithstanding its surface resemblance to an investment. *See* Interpretive Letter (November 4, 1994) (available in Lexis-Nexis) (bank provided financing to owners of natural gas leases by acquiring interest in business trust that owned working interests in the leases; acquisition of interest in trust that held leases necessary for the bank to be eligible to receive federal tax credit).[4]

The alternative form of the transaction in the Project Financing Letter did not change the fundamental substance of the bank's role as a provider of credit-equivalent financing. Other than the form of the interest the bank acquired as the vehicle to provide financing, the transaction addressed in this letter is substantially identical to a loan transaction. The bank represented that its decision whether to enter into the transaction would be based upon a full credit review of the borrower, that the proposed transaction would be made pursuant to the bank's standard loan underwriting criteria, and that the documents governing the transaction would contain many of the same terms, conditions, and covenants typically found in lending and lease financing transactions, including representations and warranties, conditions precedent to the funding pertaining to the mitigation of risks, covenants requiring the company and other investors to provide the bank with customary financial information, and covenants restricting the company from taking certain actions.

Similar to a financing transaction, the bank would be repaid in installments over time. In fact, the form of structured financing for wind energy projects is similar to a production payment

[4] Under 12 U.S.C. 24(Eleventh), national banks may provide financing for low-income housing development projects by acquiring an equity interest in limited partnerships and limited liability companies that hold and develop the properties. Ownership of the equity interests enables the banks to receive federal tax credits.

loan transaction frequently used in oil and gas lending. A production payment loan transaction is a form of lending frequently used in extending credit to the oil and gas industry. These production payment lending transactions, also called "oil/gas reserve based loans" and "oil/gas production loans," are recognized and permitted by the federal banking agencies.[5]

Moreover, the transaction will be regulated and supervised as a loan. For example, as in the case of the 1994 interpretive letter (noted above), the Project Financing transaction will be subject to the lending limits of 12 U.S.C. § 84 and 12 C.F.R. Part 32.

We subsequently made clear that our legal opinion was premised upon the following characteristics of the financing and the bank's role in the financing transaction as represented to us:

- Before advancing funds, the bank would determine creditworthiness of project.
- The creditworthiness review and determination would be made pursuant to the bank's standard loan underwriting criteria.
- Structuring the financing as a membership investment would be essential to the availability of tax credits to the bank and thereby integral to material terms of the financing provided by the bank.
- The project's agreement would contain many of the same terms, conditions, and covenants typically found in lending and lease financing transactions to protect the bank's interests.
- The bank would not participate in operation of the wind energy company, production of the wind energy, nor the sale of the wind energy.

[5] *See* OCC Banking Circular 214, OCC Examining Circular 223, and FRB Commercial Bank Examination Manual 2150.1—Energy Lending—Production Loans. *See also* OCC Interpretive Letter (November 4, 1994) (cited above).

- The bank would acquire approximately 70% of the equity interest in the company, and would look to distributions of revenue from the sale of electricity and the receipt of tax credits and depreciation expense for repayment of the funds advanced and its return on those funds.
- The bank would not share in any appreciation in value of its interest in the wind energy company or any of the company's real property or personal property assets.
- In the event the energy company does not perform as projected (which would enable the bank to obtain repayment of the funds advanced, plus a calculated return), the bank may sell its interest in the wind energy company to minimize or avoid loss on the financing.
- Alternatively, in the event the energy company does not perform as projected, the bank would have the ability to force a vote to liquidate the wind energy company to minimize or avoid loss on the financing.
- At the end of the ten-year holding period, the bank would sell at book value its ownership interest in the wind energy company. It is projected that this value would be a small percentage of the bank's original investment.[6]

III. CONCLUSION

In conclusion, I would like to assure you again that these three letters are limited and specific to the circumstances presented; they do not enable national banks to enter into the real estate investment or development business, nor do they have anything to do with real estate brokerage. Moreover, we fully appreciate the constraints the Gramm-Leach-Bliley Act placed on the ability of national banks' financial subsidiaries to conduct certain real estate activities.

[6] OCC Interpretive Letter No. 1048a (February 27, 2006).

We are mindful of the constraints that Congress, as part of its annual appropriations process, has placed on the joint Treasury Department/Federal Reserve Board rulemaking – to which the OCC is not a party – that would enable national banks and state member banks to conduct real estate brokerage activities using financial subsidiaries. Finally, because of the substantial limitations on the ability of national banks to deal in real estate, these particular interpretations do not undermine the longstanding boundaries between banking and commerce that apply to our nation's banking system.

I appreciate the opportunity to appear before you today, and I would be pleased to answer any questions you may have.

Mr. PLATTS. Thank you, Ms. Williams. We appreciate your statement.

We are pleased to have been joined by the full committee Chair, Chairman Davis. We will now move to questions, and in deference to my chairman, would you like me to go first or would you like to kick it off?

Chairman Davis is recognized for the purposes of questioning.

Chairman TOM DAVIS. Thank you. Is there a formula that OCC uses to determine the cost of real estate assessment?

Ms. WILLIAMS. We have a standard that we apply. It is not a formula, it is a standard, it is a uniform standard that is derived from Section 29 of the National Bank Act that refers to real estate that is necessary in the bank's accommodation in the transaction of its business. Generally that standard has been articulated by the courts to look to property that is acquired in good faith to serve legitimate operational needs of a bank's own banking business. And one of the factors that we look to in determining whether the property is acquired or developed in a way that meets that test will be the extent of the bank's own use of that property. So we'll look at the percentage of office space or the percentage of lodging space or the percentage of the facility that is going to be used by the bank.

Chairman TOM DAVIS. Have there been any instances that banks have violated its good faith agreement?

Ms. WILLIAMS. In the history that I am aware of, there are occasional situations where through the supervisory process we become aware that a bank's use is not what had been represented to us, or the use appears not to be consistent with holding that property for legitimate use for bank operations. In those circumstances, we have standards in our regulations that treat that property as what is called OREO, Other Real Estate Owned. That is required to be divested within 5 years with the potential for another 5 year extension. So when that holding is non-conforming, it will be required to be divested.

Chairman TOM DAVIS. Did the process that was used to issue the December 2005 letter differ from the normal OCC process?

Ms. WILLIAMS. No. No, sir, it did not.

Chairman TOM DAVIS. Also, I read your testimony, you note a key factor in allowing the financing of the windmill was so the bank could take advantage of energy tax credits. Are banks the only ones that can take advantage of that, or is that open to everybody?

Ms. WILLIAMS. The tax credits are available where a particular entity holds an equity interest in a project. So in order for the bank to provide the financing at a lower cost for the project, the bank needed to be able to take advantage of the tax credits. So those tax credits are not unique to banks.

Chairman TOM DAVIS. Let me just ask, because I am trying to understand, the simple fact that a letter was issued, does that mean that it goes beyond the previous precedent that had been established, or is that basically status quo? What does the letter mean versus no letter?

Ms. WILLIAMS. We have several standards that we apply in determining whether we publish a letter as an interpretive letter. One of those standards is where we are applying pre-existing anal-

ysis and precedent, but to a different set of facts, a new set of facts. So it doesn't mean that this is a new precedent. In this case we determined to publish these letters because we were applying existing standards and existing precedent, but the facts that were being addressed were just different, yes, sir.

Chairman TOM DAVIS. When interpretation of a letter is made, do you have a notification process that you follow after that?

Ms. WILLIAMS. What we do when we issue an interpretive letter, those are published, we have a monthly publication and they are posted on our Web site.

Chairman TOM DAVIS. Thank you.

Mr. PLATTS. Let me followup on one of the questions on the issue of good faith, which clearly is referred to repeatedly in these cases. You said if there is followup and there is a finding of, in essence, bad faith, they are not doing what they agreed to, the penalty is that they have 5 years and perhaps 10 years to divest that property?

Ms. WILLIAMS. That is what is provided for in our regulations, yes, Mr. Chairman.

Mr. PLATTS. So is there any financial penalty to the bank for not doing what it said it would do?

Ms. WILLIAMS. The other possibility is, of course, if we find that the holding and the circumstances they represented, true bad faith, we can take the position that the holding and the conduct of the bank represented a violation of law and we have the ability to take a variety of enforcement actions against the bank based on that, yes, sir.

Mr. PLATTS. How is that different than saying it is not what they said it would be, and in 5 years, it is something more egregious?

Ms. WILLIAMS. You could have a variety of circumstances which perhaps are not necessarily reflective of bad faith, but would cause a property not to be used in the way that it was initially projected to be used, and therefore not to qualify any more as bank premises. When it stops qualifying for bank premises, that is when at the very least divestiture requirements begin to kick in.

Mr. PLATTS. Maybe I will back up to kind of get a broader approach. I may come back to that same issue. But a couple of key issues that are definitions or terms here, one of which is bank premises. Is that defined anywhere in the statute or regulation, or is it more a case by case decision by the OCC?

Ms. WILLIAMS. It is a legal term, it is referred to in our regulation. But it is a legal term that is used to capture a type of property holding that is permitted under Section 29 of the National Bank Act. And in general, as interpreted by the courts and by the OCC, a bank premises constitute property that is acquired or that is developed to serve legitimate operational needs of the bank's own banking business.

Mr. PLATTS. As it applies to specifically the case in Charlotte with the hotel, it was decided that the hotel was connected sufficiently to the bank because of using what was referred to originally as 50 percent of the rooms for bank visitors, staff, that would be considered bank premises because of that use of the hotel?

Ms. WILLIAMS. Because of the level of projected committed use of the hotel by bank officials, bank visitors, current and prospective customers.

Mr. PLATTS. One specific question, in the chart you provided in that cases, it references 37½ percent versus 50.

Ms. WILLIAMS. Yes, sir.

Mr. PLATTS. Why the discrepancy?

Ms. WILLIAMS. One is based on the projections of what the likely rate of occupancy would be. The projections were not that every single room in the hotel would be filled every night. So based on what the projected occupancy rate was, the bank's projection was that they would have bank business customers occupying 50 percent of the occupied rooms.

Mr. PLATTS. Versus 37 percent of all rooms?

Ms. WILLIAMS. That is correct.

Mr. PLATTS. OK. In that chart it seems that the percentage of use, whether it be rooms or office space, runs as low as 5 percent in one of the cases referenced, a 1987 case. Is there a formula that gets to, 5 percent is a pretty small fraction versus 50 percent of the rooms or even 25, 40 percent?

Ms. WILLIAMS. Five percent would be unusual, and I think there is a situation where it might get that low. Usually, and this is just a rule of thumb, where the projected use gets below 20 percent, that is going to get a very close look from us. But it is a very fact-specific sort of analysis in each case.

Mr. PLATTS. I want to maybe walk through the process in this case again with the hotel. The bank comes and says, we want to build a hotel right adjacent to our headquarters, and I think I am safe in saying the proposal was to build that hotel in another State, is it safe to say that would not——

Ms. WILLIAMS. I think that would not have made it off the ground, yes, Mr. Chairman.

Mr. PLATTS. In this case, it was adjacent. And in the belief that half the occupied rooms would be used by banks, it was decided it is bank premises and consistent with the bank's operation. My understanding is in some of the statutes and regulations that the language is that temporary lodging of employees, customers, bank officers, where suitable commercial lodging is not readily available, is a key factor here.

Ms. WILLIAMS. That is a standard that is set out in our rules as an example that we put in the regulations of a situation that would be acceptable bank premises. But the regulation is not exclusive. And the regulation lists the types of uses in the rule as bank premises includes this sort of thing. But we were clear when we promulgated the regulation that was not intended to be an exclusive list or to eliminate situations where we would look at proposed uses on a case by cases basis.

Mr. PLATTS. So if a bank is looking at a hotel, then, they do not have to, there could be a hotel across the street that is two-thirds empty and that is not factored into, they don't have to take that into consideration whether they can justify then building a new hotel of their own?

Ms. WILLIAMS. I think we look at all of the facts and circumstances that are presented in the representations about how

the bank is going to use, in the case of the hotel, use that hotel for the particular use of their bank visitors. In this case there were representations about in some cases, difficulties about finding sufficient accommodations of the types that they were looking for for their visitors available proximate to the corporate headquarters.

Mr. PLATTS. What level of detail is required, documentation, as far as occupancy rates, of other hotels, proximity, is that required or is that just what they choose to submit?

Ms. WILLIAMS. The process in these cases involves, once the issue is identified, a very robust back and forth between both the legal staff and our supervisory staff and personnel of the banks involved to understand exactly what they are proposing to do and to make sure that we have thorough support for the rationale that they are advancing. We have seen marketing studies and marketing analyses and things like that.

Mr. PLATTS. I have a list of more questions, but I want to give the ranking member a chance to jump in here and we will come back after he is done. Mr. Towns.

Mr. TOWNS. Thank you, Mr. Chairman.

Let me begin by, can you explain more about the factors that were included in the decision to allow the development of 32 condominiums, as stated in your interpretive letter 144, is it true the bank will not be using these condos for any corporate use?

Ms. WILLIAMS. Those floors or portions of floors are proposed to be sold off. And here I think it is important to recognize what the bank was seeking to do. The bank needed office space in the footprint of its corporate headquarters. There was property there, currently occupied by some dilapidated buildings and stores. In order to have an economically viable building with offices for the bank, there was a need to build a certain number of offices.

Market studies indicate that there were limits on the likely occupancy of those offices. Additional space for hotel lodging was a critical element of the overall economic viability of the building. And then the, I think 30 some condominiums were to be sold off and the returns from that were also a critical piece to the economics of the transaction, why it made rational, economic sense for the building in the first place, in order to provide the office that the bank was seeking.

Mr. TOWNS. That wouldn't be considered speculation?

Ms. WILLIAMS. No, sir.

Mr. TOWNS. Why not?

Ms. WILLIAMS. Because what the bank is doing there is developing, creating a building where the bank is going to be using a substantial portion of the offices and has committed to use a percentage of the hotel space. This gets to the test of looking at what is the motive of the bank here. The motive of the bank is to have facilities that the bank can use. The sale of the condominium space was an element of the overall economics of the transaction. It was something that was represented to us as being an important factor in some of the local tax incentives and encouragement that was received from the city of Pittsburgh in support of the project.

Mr. TOWNS. I just find it hard not to see how that is not speculation, but maybe I just need more time with you to go in and talk

about it. But it really appears to be, I want you to know that, anyway.

Aside from the OCC ruling in December on the wind farm, are there broader circumstances in which ownership of energy projects should be permitted? Doesn't this ruling give banks a reason to become creative with their financing and lending schemes for projects that are just too risky? Wasn't the energy firm able to make a loan payment to structure other finances? Would you help me with this?

Ms. WILLIAMS. Certainly. The key here is the availability of the particular tax credit, which is keyed to the beneficiary or the immediate beneficiary of the tax credit having an equity type interest in the project. With the tax credit, the bank was able to lower the cost of the financing that it provided to the alternative energy project. The bank could have made a loan. It would have cost the alternative energy project more. The purpose behind these tax credits is to encourage financing and development of these alternative energy projects. So this was a key consideration for us in looking at the overall structure of the transaction.

We also absolutely insisted that the structure of the financing be designed so that it was in all material respects economically identical for the bank as if it were making a loan.

Mr. TOWNS. Thank you, Mr. Chairman. My time is expired. I hope we will have another round? Thank you.

Mr. PLATTS. The gentleman from Pennsylvania, Mr. Kanjorski, is recognized.

Mr. KANJORSKI. How are you, Ms. Williams?

Ms. WILLIAMS. Fine, thank you, Congressman.

Mr. KANJORSKI. I am so happy that we have the opportunity to examine this issue, because I am one of those individuals that has the pleasure of serving on this committee and also the Financial Services Committee. I participated in the original drafting of H.R. 10, which we thought had put the issue to bed.

But listening to your responses to my colleagues, it seems to me that OCC is determined to use these mechanisms and create other mechanisms to foster investment in energy and do other things that can be justified or structured in such a way as to meet the interpretive letters that were issued, or to allow for further interpretive letters without further consideration or statutory law change on the subject. Is that correct?

Ms. WILLIAMS. Congressman, I respectfully disagree. These are letters that are very fact-specific, that deal with a very narrow set of circumstances, and a very narrow type of authority that national banks have to hold certain interests.

Mr. KANJORSKI. Why do you think that what is being suggested in Pittsburgh could only be done by the bank? Why couldn't a developer or real estate firm or some other entity do that?

Ms. WILLIAMS. The situation in Pittsburgh involved property that the bank already owned. It was in the footprint of its corporate headquarters.

Mr. KANJORSKI. Could they sell the property and then become a tenant?

Ms. WILLIAMS. That is a theoretical possibility. But it has been recognized by the courts, going back over a century——

Mr. KANJORSKI. They have a right to develop an office building. I grant that.

Ms. WILLIAMS [continuing]. In a way that is——

Mr. KANJORSKI. They are putting condos in, and a hotel, and because they have visitors or users of the bank, they need hotel facilities or employees, that is used as a justification. Well, I found out the other day that somebody is coming into town to use that hotel, and they left their car in Orlando, FL. So they needed to rent a car. So I have a rental company that wants the bank to rent cars to the employees. Why isn't that an acceptable practice?

Ms. WILLIAMS. The authority that we look to in connection with the bank premises letters that we issue is very specific to bank premises real property used in connection with the bank's own business operations. Not a car rental business.

Mr. KANJORSKI. The prohibitions that we included in H.R. 10, didn't it strike you that they were there for a purpose, and that before a regulator starts making interpretive letters that they may have a need to address the intent of Congress, maybe talk to some of us that were in that conference that put that language together? You are aware of the fact that there was a great fight over mixing commerce and banking, and that there were a lot of suggestions, I think it was 20–10, 10–5, or 10–90, all kinds of different, and it came out of that conference, there was going to be no mixing of commerce and business. If you were in banking, you were 100 percent banking. If you wanted to get into business, get into business, but don't do it through a bank.

When did you think that idea of the Congress and their intent of legislating changed?

Ms. WILLIAMS. Congressman, we never thought that changed. What we have said is that the National Bank Act has very limited provisions in it that allows national banks to hold real estate in connection with their own banking business operations.

Mr. KANJORSKI. Do you think a hotel and apartments, construction of apartments is part of the banking business?

Ms. WILLIAMS. What we concluded was a mixed use building that had a substantial percentage of office buildings with a percentage of those that would be occupied by the bank for offices. A hotel and the sale of the sort of excess space, the condominiums, where the bank would no longer have any interest in that particular portion of the building, that package was needed in order for the building project to be economically viable. And that the bank demonstrated legitimate business need for those offices and the hotel space.

Mr. KANJORSKI. The hotel space? I just, is the hotel space going to be sold off to someone else, or is the bank going to operate those?

Ms. WILLIAMS. Neither. The hotel space, what was represented to us is the hotel space will be operated by an independent third-party management.

Mr. KANJORSKI. But owned by the bank?

Ms. WILLIAMS. The building is owned by the bank, yes, sir.

Mr. KANJORSKI. So the hotel will be owned by the bank, is that correct?

Ms. WILLIAMS. The hotel premises, the physical building, all of that, except what is sold off, will be owned by the bank. But the bank is not going to be operating the hotel.

Mr. KANJORSKI. That's a definition of extension of banking business.

Ms. WILLIAMS. The bank is not going to be operating the hotel.

Mr. KANJORSKI. Anybody who owns a hotel know that you can hire an operator. You are still in the hotel business. You have just contracted out the operations, that is all. You are in the hotel business, you are in a property that is a hotel. It is not an office building, it is not a bank. And suddenly you now have extended this interpretive language to allow that to happen.

How about if they want to put a Hard Rock Cafe in there, they have 40,000 square feet? Is that OK?

Ms. WILLIAMS. Congressman, I think what you see in many, many situations in many cities around the country is that banks do lease out to other companies that operate restaurants and coffee shops, their first floor space.

Mr. KANJORSKI. In their buildings that they justifiably have a right to build because they have a need for their banking business. And I don't want to be so restrictive as to stop that. I just interpreted this and the windmill project as going way over the edge, that the regulator had found what they considered in interpretive letters a right to start encouraging the banking institutions to get into the real estate investment business. And that is what they are in.

Now, the bank, if it wants to do that, all it has to do is give back their Federal charter and become a private bank, and you can build all the hotels you want to, directly. Why should we be underwriting to the full faith and credit of the United States the deposit insurance for that bank who is going out and not only building office space that they immediately need but building condos and hotel space that isn't for their business purpose? Why should we subject the liability of the American taxpayer to that type of a business venture?

Ms. WILLIAMS. Let me reaffirm that we very much recognize the fundamental separation between banking and commerce in this country, and that we recognize the limits, the substantial limits that apply to the ability of banks to hold interest in real estate. We absolutely will abide by those limits in the way that we apply them to all national banks. There was no intent and no design for these letters to constitute or to signal that banks are going to be getting into the real estate development or real estate investment business.

Mr. KANJORSKI. We in Congress wouldn't even have known of these private interpretive letters except, and I can't even tell you how it came to my attention, but it came to my attention by chance. Other than that I would have never know that a bank is going to build a windmill farm and build a hotel. And let me tell you, I am very sympathetic to this particular bank. It is in my home State of Pennsylvania. So if anyone would want to, and certainly Pittsburgh, and I know Pittsburgh needs the redevelopment, I am not opposed to redevelopment, I am not opposed to the bank getting involved and lending money to developers to build property.

What I don't like about the idea is I think the OCC has now found, through interpretive letters, the ability to expand the intent of Congress without coming back to Congress to find out whether they are acting in accordance with their mandate under the stat-

ute. And it just seems to me that the Comptroller had the duty that when this question needing an interpretive letter comes up, that could merge banking and commerce in some way that was not desirable under H.R. 10, that somebody down there should have said, you know, maybe we should pass this through the proper authorities in Congress who passed this law and give us this statutory right to exist instead of what I consider amending the law, and doing it in quite a secret manner, which is very disappointing. I can't imagine what other interpretive letters must be down there, but I will be they are dingers.

Ms. WILLIAMS. If I could address both of those just briefly. The interpretive letters are published, they are published monthly in a compilation of interpretive letters, and they are also posted on our Web site. We have absolutely no desire or interest in being secretive about this. In fact, we probably bend over backward to publish——

Mr. KANJORSKI. If I may interrupt you, there were several interpretive letters in the 1990's that were not published on your Web site and were only published after we raised this question. Those letters, no one outside your agency knew of their existence, except the principal parties involved.

Ms. WILLIAMS. Congressman, respectfully, they were available in Lexis-Nexis which is a computer research data base.

Mr. KANJORSKI. Well, I check it every night after dinner. I mean, I wouldn't go to sleep if I didn't examine every interpretive letter that may be on Nexis. [Laughter.]

Ms. WILLIAMS. I think it is very important for me to be very clear here that there was absolutely one, no intention of doing anything with any secrecy. We published the letters, it was our intention to be entirely transparent. And we did not view the positions that we took in the letters to be a breach in the separation of banking and commerce.

Mr. KANJORSKI. One more question, Mr. Chairman?

Mr. PLATTS. One more. As my senior member of my State delegation, of course. [Laughter.]

Mr. KANJORSKI. Would you be amenable to requesting a hearing before the Financial Services Committee to take this particular issue up and have a full hearing on this whole issue?

Ms. WILLIAMS. Congressman, I am really not in a position to take a position for my agency on that question.

Mr. KANJORSKI. Can you tell me what you would recommend to the Comptroller?

Ms. WILLIAMS. I would want to talk to the Comptroller on it. I am not in a position to state a position on that.

Mr. KANJORSKI. We are having a hard time getting that hearing. We have been requesting it for a number of years over there. I can assure you one thing, come November 7th, if there is a change, there will be a hearing.

Mr. PLATTS. Mr. Kanjorski, thanks for your questions. As this hearing shows, you will have to wait until November 7th. We are glad to have the hearing today.

I do want to followup on one of the issues though about the publication letters, that they are public. But they are public once they are a done deal. They are public that here is the decision, and it

has already been resolved, that there is no publication of it while it is an ongoing matter for the public or Members of Congress to have a role in input to that, is that a fair statement?

Ms. WILLIAMS. Mr. Chairman, the process that we follow, it is the same process that the Federal Reserve, the FDIC, the OTS, follows with respect to requests for interpretations of existing law. That is that the income requests are not published, but the answers, and in our case, if they make new precedent, if it is a new precedent or if it applies existing precedent to new facts, they absolutely are published at that point.

Mr. PLATTS. Is there a prohibition from publishing the income requests?

Ms. WILLIAMS. There may be issues in connection with some of the material that we receive, that it may be confidential business proprietary information. There may be issues under, for example, the Trade Secrets Act about our ability to make them publish.

Mr. PLATTS. I very much respect parts of it certainly would be proprietary. But given that it is an action that is going to in essence rule on what the law means, it seems that we would be better to err on the side of public disclosure that there is this question of interpretation out there and anyone who would want to have input it would seem wise to allow the public to have that input.

But I want to get to a number of other questions, because of the time that we have. In talking about the Pittsburgh case, you talked about the motive of the bank is what you look at. It seems like that is ignoring the motive of the bank is appropriate within the requirements of the law, in other words, to Mr. Kanjorski's point that separation of commerce and banking, the bank could have great motives, this is really about us having this facility, but the impact may be on commerce, whether their motive is sincere or not.

I think it is fair to say, using the condominiums, the fact that there is going to be 32 condominiums for sale on the market, that is going to impact commerce, other condominiums on the market in downtown Pittsburgh. Is that a fair statement?

Ms. WILLIAMS. Mr. Chairman, I don't know that I could speak to the impact on the condominium markets in Pittsburgh.

Mr. PLATTS. You just, you can't tell me whether putting 32 condos for sale here will impact the price of 32 across the street or down the block? I mean, that is a rhetorical question almost, really. I think it is a given that those condos are going to impact the market in that community.

Ms. WILLIAMS. The key with respect to the condominium piece of this particular building was that the ability to sell those condominiums to, in this case——

Mr. PLATTS. To reduce the cost of the whole structure?

Ms. WILLIAMS [continuing]. Of the overall structure, to get the bank out of a role where you might argue that it was even more involved in commerce, if it were in charge of leasing those out.

Mr. PLATTS. But the fact that they are building and then selling them certainly is going to impact that market. I will answer my question, and say yes, which I will say kind of argues that it is commerce. But the premise for allowing it, if I understand it, was to, it was an element of the overall economics of the project, to bring down the total cost of the project?

Ms. WILLIAMS. That is correct.

Mr. PLATTS. So do you look at the profit margin of the project in reviewing the merits of what all is included in the project?

Ms. WILLIAMS. We look at the representations that the bank provides us and their studies and their marketing materials about what were the components needed to have a viable project in this case. And we had information about the levels of office use, occupancy, the levels of hotel room occupancy and looking sort of cumulatively at the potential uses of the building, the overall economics of the building, when you cumulate those uses.

Mr. PLATTS. So as part of the review, it was that in reviewing the merits of the project, you look at, here is the package they are putting together they think is viable. The alternative is what they really want is office space, 20 percent or so, and then some hotel rooms, right? You look at what would it cost the bank to just build an office building or lease office space and to just rent hotel rooms to make that comparison? Because that really, if you don't do that, it is hard to know the economics, to assess the economics of the project.

Ms. WILLIAMS. What we look at is here the bank has a piece of property that it already owns. And it is looking at how it can use that property to get the uses that it needs. And the facts in this particular case were that in order to get the uses that the bank wanted to get out of that particular property, that the project needed to be this multi-use type of building.

Mr. PLATTS. That is assuming that in taking this property, another option was to sell it to somebody to develop the office buildings and hotel, and then they lease back. Is that part of the analysis of them getting what they need out of that property?

Ms. WILLIAMS. When we look at a situation like that, one of the things that guides us is the way that the courts have construed the ability of national banks to hold and develop property that they own. The bank here didn't go out and buy this yesterday. They have held it.

Mr. PLATTS. So if they had gone out and bought it yesterday, that would have made it different?

Ms. WILLIAMS. We would have, again, looked at the facts and circumstances there and evaluated. But here they have property. And the question is, or the standard is that they are allowed to use it as a rational owner of property would use property in order to achieve the desired and permissible use.

Mr. PLATTS. For the bank, for its bank operations?

Ms. WILLIAMS. Correct.

Mr. PLATTS. But it kind of comes back to where I was earlier, in your 1996 rule that talks about real estate, owning real estate, and the reference about the temporary lodging with the hotel, in Charlotte, where suitable commercial lodging is not readily available. If I back up prior in that regulation, it says a national bank may invest in real estate that is necessary for the transaction of its business.

So the first question before you can get into what type of real estate it is, is this necessary. That is where I think we are trying to get to the issue of is it necessary to build your own building that requires hotel and condos to be part of it to justify the economics

of it, or is it OK to just lease space? Once you cross that threshold and say, yes, you have to build your own building, I think then you get to the danger of the statutory prohibition against commerce. I think that is what we are really going after.

Let me give you an example of where would the limit be. Under my understanding of the regulations and the law is, it could be not just for temporary lodging, but it could be housing for bank officers, that if a bank wants to build a home for the bank president, that would be permitted under the regulations?

Ms. WILLIAMS. I doubt that would be the case, but we would have to look at the particular situation, if there was a reason why there was a banking business need to do that.

Mr. PLATTS. If the banks says, well, we want to provide all of our senior management free housing, and so we are going to build these four homes, how is that different than saying, we want to provide temporary housing for our employees or our visitors when they come? I would think you could make that argument, so if I can build a hotel, I can build the houses. Now if I build the houses, to make it commercially viable to build these four, I am actually going to develop 20 homes in this development and sell 16 of them, why does that analogy not work?

Ms. WILLIAMS. I think because it is missing the kind of linkage that we had here to the operational business need of the bank to have the particular facility. The bank can compensate its executives in such a way that they can go out and buy nice, nice homes.

Mr. PLATTS. They can reimburse their employees to go rent rooms in hotels not owned by the bank. How is that different?

Ms. WILLIAMS. Well, again, here we had a situation where the bank had property——

Mr. PLATTS. But the issue of having property I don't think is the first question. The question is, is there another alternative to hotel space then buying or building our own?

Ms. WILLIAMS. And the question that we answer first, guided by the way the courts have looked at this statutory standard, is not, could they do it another way. But it is whether the bank is proposing in good faith a type of development that is consistent with the bank's legitimate business needs.

Mr. PLATTS. But shouldn't the question be, can they do it another way? If I am reading the 1996 rule correctly, it says investment in real estate necessary for the transaction of business. A national bank may invest in real estate that is necessary for the transaction of its business. I think the key question is, what is necessary. So that should be the first question, not how are they going to do it, but is it necessary to do it.

Ms. WILLIAMS. I have been avoiding trying to sound too much like a lawyer here and getting into the history of certain terminology under the National Bank Act.

Mr. PLATTS. That is probably one of the challenges. We are all looking at the language differently.

Ms. WILLIAMS. The word necessary has a fairly substantial history of how it has been construed and used in the National Bank Act context. It has not been construed as meaning essential or indispensable. It has been construed as being useful, convenient, useful for the conduct of the bank's business. And so we are not, when

we look at that word necessary, for us as OCC lawyers, we are reading it against the backdrop of that case law.

Mr. PLATTS. If I look up the word necessary in the dictionary, off the top of my head I would think it would be imperative, critical, I don't have a dictionary here, but it is pretty plain English, isn't it? To interpret it that it can be subjective in a pretty broad sense is contrary to what it says.

Ms. WILLIAMS. This is a situation where that is not our interpretation. It is the interpretation that has been developed by the Federal courts over the years.

Mr. PLATTS. Since 1996, since that ruling?

Ms. WILLIAMS. Prior to.

Mr. PLATTS. But this is a ruling in 1996, a new rule, right?

Ms. WILLIAMS. But when we use that term, in the banking context, in the context of the National Bank Act, it has a meaning the way the courts have construed it in the past.

Mr. PLATTS. It has been a while since I was in law school, and I haven't practiced in a while. But using one word in a new setting doesn't necessarily automatically mean the courts will look at that word. Because here it is pretty straightforward, it is necessary for the transaction of its business. That seems like pretty straightforward English to me.

But we could probably go back and forth and I appreciate, you have been very kind, helping us try and get to the bottom of what you believe but how we interpret it.

Ms. WILLIAMS. And if I could just add one other thing concerning the particular regulation. The regulation is not designed to be an exclusive list of permissible bank premises. It speaks in terms of our examples, including those——

Mr. PLATTS. Yes, but that first part, that it is necessary for the transaction of business, is a mandate. That seems to me the way it reads. But I have one more example, and I want to allow my colleagues to have their second opportunity. Maybe the house was an extreme example. Let's talk about a new branch of the bank. We want to be right here in the hub of all the action in the community. So we propose, we want to build a new mall with the center of the mall being our bank. Are we allowed then to develop that mall, because the center of the mall we are going to make sure is ours and we are going to sell off the rest of the mall once we develop it? Is that within the premise of banking premises?

Ms. WILLIAMS. I think not, because the way that we would look at that situation, the way you have described it, we would look at the relative use of the footprint of the whole property that you are describing, how much of that is bank branch, how much of that is other.

Mr. PLATTS. What if it is just five stores, bank and four stores, so percentage, it is 20 percent as in the hotels, or 5 percent? If it is not 1 percent, but it is our branch and four other similar size stores, not big department stores, but are we allowed to develop the property? I think that is what goes to this whole issue, is our interest in, what is or what is not allowed, and when do you get to that commerce?

So I would see that very much as commerce, developing a shopping center, even a small shopping center. And I don't know how

you separate that from 20 percent of hotel rooms we are going to use or 37 percent of hotel rooms. I don't know how you separate that. I think that is a concern here. It seems like there is no defining line of commerce yes or no, but it is a very, very dull shade of gray of what is allowed or not allowed.

Ms. WILLIAMS. It is, in many, many respects, as I said, these are very fact-specific determinations. In the situation that you describe, we would look at the percentage of the property that is going to be used for the bank branch. We would ask, did you have to buy all of it, if it is an acquisition?

Mr. PLATTS. Final question, I promise, before my colleagues here, but wouldn't again the first question be, well, can't you lease that space from a developer that owns and buys the land and develops it and you lease it? Because that is clearly then, somebody is taking the risk of the development and getting into the commerce of which you are getting the use of that commerce through your lease? It seems like that should be the first question, given that the Congress has said no commerce. It seems like we are skipping that question to say, well, let's look at percentages, not, is it commerce or not, which should be up front.

Ms. WILLIAMS. And I think the scenario you are posing, where the bank is acquiring the property and asking that question, really does highlight how fact-dependent these situations need to be and because of that, how narrow this sort of authority is. It is just not a general authority for banks to go out and do real estate investment and development.

Mr. PLATTS. I agree it is not an authority, but it certainly provides a pretty strong precedent, whether it is called that or not, that if you didn't allow others to do it they would say, you are treating us unfairly and that is unequal treatment under the law. I guess, Mr. Towns, did you have other questions?

Mr. TOWNS. Yes. It appears to be that you are involved in commercial development and paying for your headquarters at the same time. That is what it appears to be. So maybe, Mr. Chairman, if we could just get a summary of the case law, just these three decisions, maybe that would help us some. I would like to make a request.

Mr. PLATTS. Ms. Williams, if you could provide that to us in writing.

Ms. WILLIAMS. Certainly.

Mr. PLATTS. We will keep the record open, the case law that OCC looked at in reviewing these requests, that is what you are asking for, Mr. Towns?

Ms. WILLIAMS. Absolutely. We would be happy to do that.

Mr. PLATTS. Thank you.

Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman. You didn't quite answer one question for me. The relationship between the hotel and the bank, is that a management contract with some entity to manage the hotel?

Ms. WILLIAMS. I believe it is, sir.

Mr. KANJORSKI. Does that entity have a lease on that space for a term of years? Does it pay an agreed-upon amount to the bank?

Ms. WILLIAMS. Congressman, I would have to back to you on the specifics of that.

Mr. KANJORSKI. Well, wouldn't you think that would be important as to who has the risk? We are talking about commerce and separating it from banking. And commerce is the risk side of business. Banking is supposed to be the conservative, safe side. But it seems to me that if you went through all these machinations, if you really wanted to follow the intent of the law, you would have said, well, you have to enter into a lease for a term of years with the operating company so that we are assured so much money will return and that won't risk our depositors.

If you don't have a lease, they are at-will, able under the contract to be dismissed and another one hired, so you can be very speculative there for profit purposes. That is commerce. That is not banking. Didn't that come to your attention?

Ms. WILLIAMS. One of the challenges here, when you are talking about how the particular type of facility that is being proposed could be owned and the interests the different parties might have in it or the contracts——

Mr. KANJORSKI. They own the building. They are also in the hotel business unless they lease out that to someone who has a set term with a set amount and they are assured of that repayment, they are not involved in the business, they are not going to get the upside or the downside, they're just going to draw the lease payment.

Ms. WILLIAMS. Depending upon the party that enters into the lease with the bank under the hypothetical that you are proposing, and depending upon what arrangement that party might have with the management company, the risk to the bank as the building owner is not necessarily going to be less with the variations on how this operation might be structured with the different contractual relations.

Mr. KANJORSKI. Would you agree that the bank should be allowed to lease it out to the president's brother-in-law, who is penniless?

Ms. WILLIAMS. Not the president's brother-in-law, probably. But there are different ways that this could be structured.

Mr. KANJORSKI. The fact of the matter is, the examiners here have to make an examination as to the soundness of this deal, don't they? So they would have to do due diligence, they would have to search out who this operator is, what their experience is, what kind of assets they have in support of the situation, and what are the vital terms of the contract? Is it profit sharing with the bank? Do you know whether it is profit sharing?

Ms. WILLIAMS. I would again want to get back to you to make sure that I gave you a completely accurate answer. But the examiners did look at the materials that the bank had.

Mr. KANJORSKI. I assume they did. And that raises the next question that I have. Have you put a new drive on to hire expertise, entrepreneurs over the OCC? I have never met a bank examiner that would be able to tell me what the likelihood of success in a windmill farm would be and what the profits could be anticipated or expected and what all the foibles are to entering into that energy business. It is a highly speculative business.

Ms. WILLIAMS. What I noted in my written statement is that the particular financing in question has a substantial resemblance to certain oil and gas production loans. Also, that one of the fundamentals of our issuing the interpretive letter was that the financing had to be structured so that it was economically functionally equivalent to the situation had the bank extended a loan. So yes, we do have examiners that are quite knowledgeable in this type of financing.

Mr. KANJORSKI. Why didn't they just extend a loan to the windmill operation?

Ms. WILLIAMS. The desire here was to be able to lower the cost of financing to the alternative energy project. And——

Mr. KANJORSKI. They have a right to charge a lower rate.

Ms. WILLIAMS. In order to lower the rate from what would be their ordinary charge for that type of commercial credit——

Mr. KANJORSKI. They are looking at the profit to justify a lower rate, isn't that a fact?

Ms. WILLIAMS. They are looking at their hurdle rate for their use of capital.

Mr. KANJORSKI. You don't see that they are getting that upside of profit in these deals and that is why they can reduce the interest rates, etc? Because they are participants in the business, in the commerce.

Ms. WILLIAMS. They are getting payments that are structured to resemble payments on a loan.

Mr. KANJORSKI. Well, maybe you should examine some of your loans on other regards, I don't know.

Mr. PLATTS. Mr. Kanjorski, could I just followup right on that to make sure we understand?

Mr. KANJORSKI. Yes.

Mr. PLATTS. The reason that the windmill was structured the way it was was to get the tax credits. But is it fair to say that the bank is saying, well, because we are going to get these tax credits, we can therefore offer less expensive, which in essence the tax credits became in place of profits from the windmill project, right? So we were getting profits over here, i.e., tax credits, and therefore we can charge less?

Ms. WILLIAMS. It was in place of a higher financing cost on a loan.

Mr. PLATTS. But the reason they could charge less is because they were getting the tax credits. I think that is Mr. Kanjorski's point, is they are getting a profit above the loan, the tax credits from the Federal Government, really, is where the profit is coming from. That is what allowed the lower rate to be charged. I think that is what you are getting at.

Mr. KANJORSKI. Absolutely.

Mr. PLATTS. Isn't it——

Ms. WILLIAMS. I guess I would describe it a little bit differently, that the bank is looking for a particular rate of return on the financing that it extends. When it puts the tax credit benefit into the mix, it can get a lower rate of return from the particular project. But yet overall get the rate of return that it is looking for as an economic matter.

Mr. KANJORSKI. And one other element. They own the property. So if it appreciates, they get the profit on appreciation.

Ms. WILLIAMS. No, sir, the bank owns an interest in a limited liability company. It will have no upside or downside in the value of the underlying real estate. We made that very clear in the second legal opinion that we issued to make sure that everybody understood that very clearly.

Mr. PLATTS. Perhaps one or two. We need to get to our second panel here.

Mr. KANJORSKI. You have examiners that have all the expertise to get into these commercial examinations and do it with the expertise of investment houses, is that correct?

Mr. PLATTS. We have examiners that understand this type of financing arrangement, and that are quit expert in it, yes, sir.

Mr. KANJORSKI. You have, there are three interpretive letters here. And just to be sure, until we get an opportunity to get back to this at some point, can you give me assurances that these three letters will not be used as precedents for any other requests that are made for widening this hole or this crack between banking and commerce? Or is that something you can't confirm?

Ms. WILLIAMS. I don't think the letters themselves will be used as precedent. We look to the underlying limited statute.

Mr. KANJORSKI. Can I be assured that neither the Office of the Comptroller of the Currency will recognize that three other instances certain permissions were given and therefore, if another request that those instances would be cited has been justified as being within banking necessity?

Ms. WILLIAMS. Congressman, I can't tell you that we will never put these in a footnote someplace in a legal opinion. What I can tell you is that the underlying conclusions that we reached go back to the statute.

Mr. KANJORSKI. So what you are telling me is in your opinion, as you have acted and the way you have acted and the way you have interpreted, that is the way you are going to go and continue unless the Congress of the United States calls a section up and rewrites it, is that correct?

Ms. WILLIAMS. No, sir, and I am sorry if I gave that impression. If we have any subsequent requests, and I must tell you that we have not received anything like this since these letters were issued, so they have not served as a catalyst for any sort of tidal wave of requests to the OCC to take advantage of these positions. We will apply the standards in a narrow and careful fashion and we will be very, very sensitive to the issue of maintaining the separation of banking and commerce.

Mr. KANJORSKI. Do you consider this narrow, this interpretation, narrow?

Ms. WILLIAMS. We do.

Mr. KANJORSKI. Wasn't there a request by J.P. Morgan Chase of a similar nature that was pulled after this disturbance?

Ms. WILLIAMS. We had a request for an interpretation that dealt with something that is referred to as volumetric production payments. And it doesn't have anything to do with land. It pertained to intangible interests in certain royalty payments and a financing

connected to those interests. And that is a type of financing that, for example, is allowed in bank holding companies.

Mr. KANJORSKI. But that was pulled?

Ms. WILLIAMS. They chose not to go ahead with it, yes.

Mr. PLATTS. Mr. Kanjorski, thank you. We are going to need to move on. Ms. Williams, we appreciate the interaction. I think as you saw from all of us, there certainly seems to be a lot of uncertainty of what is or isn't. I understand that it is very fact specific.

But I think the law that Mr. Kanjorski certainly played a critical role in is pretty clear, fact specific notwithstanding, as in no commerce. I hope that OCC will look at that as a starting point, that to me, what the law requires or actually prohibits regarding commerce as a starting point, not the motive of the bank. You start with, is this allowed under the issue of commerce/no commerce. And I think the example of these all raise some questions about that.

But the bottom line is there is certainly a lot of uncertainty out there. And I think even the order of the decisions being made, two on the same day and the third, but the bank, hotel, office space being first and selling condos, then a freestanding hotel and then a windmill project is kind of like we are going further and further down the line.

So we appreciate your interaction with us and your service at the OCC and the information that was requested regarding the lease arrangements, the location as well as the case law, you and your staff following up with us, we will keep the record open for that.

Ms. WILLIAMS. Thank you. And let me just reaffirm our sensitivity to this issue and appreciation of your concerns and our intent that the letters in question were very narrow in focus and scope and intended to be very narrow in their impact.

Mr. PLATTS. Thank you, Ms. Williams. We will break for about 2 minutes, just as we reset our second panel, and then we will continue with the hearing. Thank you.

[Recess.]

Mr. PLATTS. We will reconvene the hearing with our second panel. Before we do introductions, if I could ask you to rise and we will swear you in together and then proceed to introductions.

[Witnesses sworn.]

Mr. PLATTS. Thank you. You may be seated. The Clerk will note that all witnesses affirmed the oath.

We are pleased to have with us three distinguished witnesses: Mr. Ed Yingling, President and CEO of the American Bankers Association; and Ms. Cynthia Shelton, Commercial Real Estate Broker with Colliers Arnold of Orlando, FL. And for our third witness, I am going to turn to the chairman of the full committee, Mr. Davis, for an introduction.

Chairman TOM DAVIS. I am proud to have a friend and neighbor of long standing here, and that is Tom Stevens, who lives in the 11th District in the town of Vienna with his wife, Lindy. He is the President of the National Association of Realtors, which is America's largest trade association, representing more than a million members. He has been a realtor since 1972. He is currently, as I said, the president.

He is an active member of our community. He has been involved in charitable organizations like the Cerebral Palsy campaign of the National Capital Area, the American Cancer Society, and numerous others. He has been helping our local and State Government to improve on transportation. We dealt with him early on, when I was chairman of the board, on a number of issues affecting realtors. He is active in the chamber out there in Fairfax. I am just very proud to have you here today.

Mr. PLATTS. Thank you, Mr. Chairman. We are going to move to your testimonies. Again, we are going to give you 5 minutes on the clock, if you need to go over a little bit.

What we are going to do, we expect to have to leave probably in about 35 minutes for votes. The vote may come up earlier and we would have to go over. What we would like to do is get your testimonies in and at least have a good dialog with you, Q&A before that, so hopefully we don't have to have you stay while we are over there voting.

So with that, Mr. Stevens, we will begin with you.

STATEMENTS OF THOMAS M. STEVENS, CRB, CRS, GRI, PRESIDENT, NATIONAL ASSOCIATION OF REALTORS; EDWARD L. YINGLING, PRESIDENT AND CEO, AMERICAN BANKERS ASSOCIATION; AND CYNTHIA C. SHELTON, CCIM, CRE, DIRECTOR OF INVESTMENT SALES, COLLIERS ARNOLD

STATEMENT OF THOMAS M. STEVENS

Mr. STEVENS. Thank you, Mr. Chairman. Good afternoon, and thank you for having us testify. Thank you to Ranking Member Towns and Chairman Davis for that introduction. I appreciate it.

My name is Tom Stevens, and I am the former president and owner of Coldwell Banker Stevens, now known as Coldwell Banker Residential Brokerage Mid-Atlantic. I am the 2006 President of the National Association of Realtors. I appreciate the opportunity to present the views of our 1.3 million realtor members on the Office of the Comptroller Decision to expand national bank authority to engage in real estate development, ownership and commercial banking.

Last December, the OCC expanded the authority of the banks to engage in commercial real estate activities through three separate rulings. The first decision allows PNC Bank to develop a project involving retail space, offices, a hotel and 32 speculative condominiums. The second decision approves Bank of America's request to develop a Ritz Carlton hotel in which less than half of the rooms will be used for its own business purpose. And the third decision authorizes Union Bank of California to own 70 percent of the equity interest in a windmill farm.

Why have NAR and other industry participants urged Congress to hold today's oversight hearing? NAR and others are concerned that the OCC has inappropriately expanded congressionally established bank powers. In essence, they have created new law without public participation and without publication in the Federal Register.

Furthermore, NAR believes the OCC's represent a far departure from what is permitted by the National Bank Act, which elevates

our concern that the rulings will inevitably lead to an irreparable breach in the laws separating banking and commerce. The OCC has repeatedly claimed that the three rulings have nothing to do with real estate brokerage. Contrary to what you may have heard from the OCC officials and banks, NAR has never said that the rulings permit national banks to engage in real estate brokerage. What we have stated and still firmly believe is that the OCC's actions set in motion a process that will result in their authorizing national banks to engage in real estate brokerage, which is currently prohibited. Such expansion will dramatically increase the risk and exposure of national banks and threaten safety and the soundness of the Nation's banking system.

The OCC gave Bank of America the green light for a Ritz Carlton hotel project based on their banks premises rule, which allows a bank to invest in real estate if the property is used for temporary lodging and areas where suitable commercial lodging is not readily available. We believe the OCC unreasonably stretched its own rule when approving the Ritz Carlton project, because our own scan of the immediate area reveals a 365 room Omni Hotel already in the Bank of America plaza, and a 434 room Marriott directly across the street from the bank's headquarters. We would like to know why Omni and Marriott, both a stone's throw from the bank's front door, are not suitable.

The PNC Bank approval included another creative interpretation by the OCC, specifically the bank's proposal to build and sell residential condominiums which were in no way related to the business of the bank. PNC asked for this condo ruling to make the mixed-use development project economically feasible. To us it sounds as if a national bank can virtually any type of commercial or residential real estate development project, so long as the bank says an activity is needed for the economic success of the project.

And last but certainly not least, the OCC allowed Union Bank of California to own 70 percent of a windmill energy project. In the ruling, the OCC disregarded its own guidance on whether or not the windmill investment was an integral part of the business of banking and instead, relied on the economics of the deal, the deal being that the transaction is structured as an investment, rather than a loan, to take advantage of certain tax credits. Interestingly, the OCC is not requiring the windmill company to repay the principal. Instead, the bank will receive periodic payments based on revenue generated by the windmill farm. I hope for Union Bank's depositors that it is very windy in California.

In conclusion, we believe that with these three real estate rulings the OCC has opened the door and all but invited in national banks to engage in widespread real estate development, which breaches the fundamental separation of banking and commerce. Accordingly, we ask Congress to urge the Comptroller to reconsider the December 2005 rulings, and we ask you to direct the OCC not to take any future actions that have the intended or unintended result of expanding banking powers to engage in real estate development.

I thank you for the opportunity and would be more than happy to answer any questions.

[The prepared statement of Mr. Stevens follows:]

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HEARING BEFORE THE

HOUSE GOVERNMENT REFORM

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, FINANCE AND ACCOUNTABILITY

ON

OFFICE OF THE COMPTROLLER OF THE CURRENCY'S DECISIONS TO ALLOW NATIONAL BANKS TO ENGAGE IN REAL ESTATE DEVELOPMENT, OWNERSHIP AND MERCHANT BANKING

WRITTEN TESTIMONY OF THE

NATIONAL ASSOCIATION OF REALTORS®, SEPTEMBER 27, 2006

Chairman Platts, Representative Towns, and Members of the Subcommittee, my name is Tom Stevens, and I am the former President of Coldwell Banker Stevens (now known as Coldwell Banker Residential Brokerage Mid-Atlantic) – a full-service realty firm specializing in residential sales and brokerage. Since 2004, I have served as senior vice president for NRT Inc., the largest residential real estate brokerage company in the nation.

As the 2006 President of the National Association of REALTORS®, I am here to testify on behalf of our more than 1.3 million REALTOR® members who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors and others engaged in all aspects of the real estate industry. Members belong to one or more of some 1,400 local associations/boards and 54 state and territory associations of REALTORS®. Additionally, they can join one of our many institutes, societies and councils to enhance their expertise and network with other professionals globally. Working for America's property owners, NAR provides a forum for professional development, research and the exchange of information among its members, and with the public and government for the purpose of preserving the free enterprise system and the right to own real property. I appreciate the opportunity to share our views on the Office of the Comptroller of the Currency's (OCC) real estate decisions.

NAR Opposes OCC Real Estate Development Rulings

In December 2005, the OCC announced it was authorizing national banks to engage in real estate development, ownership and merchant banking through three separate interpretive rulings. The first decision allows PNC Bank to develop a project involving retail space, offices, a hotel, and 32 condos (for immediate sale to make the rest of the project feasible). The second decision approves Bank of America's request to develop a luxury hotel in which less than half of the rooms will be use for its own business purposes. And the third decision authorizes Union Bank of California to own 70 percent of the equity interest in windmills and the associated real estate, under the pretext that the ownership interest was taken in connection with financing the project.

NAR is extremely concerned that the OCC's December 2005 decisions (issued via interpretive letters) authorizing national banks to invest in real estate projects involving the development of office buildings, hotels, residential condominiums and windmill farms inappropriately expand the powers of national banks to engage in real estate development and merchant banking.[1] Since these OCC interpretive letters became public, NAR and other industry participants have urged Congress to conduct oversight hearings on the Comptroller's decisions as well as examine whether or not the OCC has become too beholden to the banks they regulate – the same banks that fund the agency's operating budget – without any real accountability to the Treasury or to the U.S. Congress. NAR is concerned that the OCC is expanding congressionally established bank powers – in essence, creating law – without public notice and comment, without public participation, and without publication in the Federal Register or the Code of Federal Regulations.

The OCC has repeatedly claimed that the three rulings have nothing to do with real estate brokerage by national banks. We accept that notion, at least for today, and have never stated that the OCC's December letters permit national banks to engage in real estate brokerage. What we have stated and what we still firmly believe is that the OCC's actions set in motion a process that will result in the regulator authorizing national banks to engage in real estate brokerage, which is currently prohibited. Such activities will markedly increase the risk exposure of national banks and threaten the safety and soundness of the banking system. Moreover, permitting national banks to engage in real estate brokerage and management undermines the longstanding, Congressionally-mandated separation between banking and commerce. These same concerns, by the way, apply to state banks with "wild card" authority to engage in any activities permitted for national banks.

NAR maintains the OCC actions represent a marked departure from what is permitted by the National Bank Act, the OCC's regulations and previous OCC decisions and underscore our concern that the rulings will inevitably lead to an irreparable breach in the wall separating banking and commerce. The Comptroller and other OCC officials have defended the decisions in response to congressional inquiries, in meetings and in correspondence with NAR and to the

[1] OCC Interpretive Letter No. 1044 (December 5, 2005) (Condominium Letter); OCC Interpretive Letter No. 1045 (December 5, 2005) (Hotel Letter); OCC Interpretive Letter No. 1048 (December 21, 2005) (Windmill Letter).

media. Yet despite the Comptroller's statements alleging a "fundamental misunderstanding"[2] of the effect of the decisions, numerous banking experts see the OCC's actions as a significant expansion of real estate powers of national banks.[3] Indeed, two former Comptrollers, Eugene Ludwig and John D. Hawke, have publicly acknowledged that the OCC letters move the bar.[4]

The OCC's power exertion is by no means limited to the December decisions. In January 2004, the OCC dismissed public comments and Congressional concerns and published a final regulation preempting state banking and real estate lending laws, including state licensing laws, for national banks and their operating subsidiaries.[5] NAR was a loud opponent of this rule because we can envision the OCC, in its continuing march to expand national bank powers, permitting national banks to develop residential and commercial real estate under the rubric of "bank premises," which was the basis for two of the December interpretive letters, and allowing banks to simply post a "For Sale" sign in order to sell such assets without the need of a licensed real estate professional.

It is important to note that the U.S. Supreme Court has agreed to consider an appeal from the Sixth Circuit that upheld the OCC's preemption rules with respect to operating subsidiaries. The case at issue, *Watters v. Wachovia Bank, N.A. and Wachovia Mortgage Company*, originates from a decision by Michigan's banking commissioner to prohibit Wachovia's operating subsidiary from engaging in mortgage lending because it was not properly registered pursuant to the laws of Michigan.[6] Wachovia maintained (and still maintains) that Michigan mortgage licensing registration statutes at issue are preempted by the National Banking Act and the OCC's regulations. Not surprisingly, the OCC has defended Wachovia at the District and Circuit court level. NAR is one of 24organizations and 51 state attorneys general that have filed *amicus curiae* briefs with the Supreme Court arguing that the OCC has misused its power and

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[2] OCC News Release 2006-3 (January 11, 2006).
[3] Banks Might Widen Real-Estate Role," *Wall Street Journal* (January 9, 2006); "OCC Moved the Line on Realty in UBOC Letter," *American Banker* (January 11, 2006). "Tough Enforcement Belie Effort to Expand Bank Powers," *Financial Services Policy Bulletin*, Stanford Washington Research Group (January 25, 2006). "Will Banks Become Land Developers?" CNN Money (January 9, 2006) at http://money.cnn.com/2006/01/09/news/companies/banks_real_estate.
[4] "In Focus: Firm, But Not Specific, On Banks in Real Estate," *American Banker* (January 23, 2006).
[5] 12 C.F.R. §§ 7.4007(b)(2)(vi); 7.4008(d)(2)(i).
[6] S. Ct. Docket No. 05-1342

misinterpreted federal law by extending preemption privileges to operating subsidiaries. NAR's brief focused on the implication of the Sixth Circuit's decision on every activity in which the OCC has found – or, in the future, finds – that a national bank can engage. This could include real estate brokerage, for which national banks are actively seeking as a permissible activity for their financial subsidiaries.

Ultimately, we foresee the OCC stringing together such authority with decisions that permit national banks to participate in negotiating sale transactions on behalf of real estate investors and authorize national banks to engage in full service real estate brokerage free from any controls and protections established by state and local laws.[7] NAR strongly believes that such a result does not serve consumers and businesses well, breaches the separation of banking and commerce and is not in the public interest.

Background

The National Bank Act.

The National Bank Act imposes strict limits on the ability of national banks to own real estate.[8] Specifically, a national bank may purchase, hold and convey real estate under the following narrow circumstances "and for no others":

- Property necessary for accommodating its business.
- Property mortgaged to the bank as security for debts previously contracted.
- Property conveyed to the bank in satisfaction of debts previously contracted.
- Property purchased at sales under judgments, decrees or mortgages held by the bank or purchased to secure debts owed to the bank.

National banks are required to dispose of real estate acquired in satisfaction of debts owed to it by customers within five years.[9] National banks are also permitted to invest in bank premises in

[7] OCC Interpretive Letter No. 880 (December 16, 1999). (". . . a bank's involvement in the sale of [the real estate] could entail . . . participating in the structuring of the transaction (including negotiations with the buyer) . . . Competitors in the real estate advisory and management business offer such negotiation services. Your letter states that unless banks can offer the same range of services requested by clients, clients will search for an alternative provider of such services.")

[8] 12 U.S.C. § 29.

an amount up to the bank's capital.[10] The Supreme Court has long held that the purpose of these restrictions is to deter national banks from "embarking in hazardous real estate transactions," ensure the maintenance of liquidity and prohibit the accumulation of large amounts of property by national banks.[11]

OCC Regulations.

The OCC has adopted several regulations that address the power of national banks to purchase or hold interests in real estate. OCC regulations circumscribe the nature and circumstances under which national banks may extend credit secured by liens on real property.[12] Generally, a national bank may lend to a third party and take as security for the loan a lien on or interest in the real estate.[13] OCC regulations define a "loan or extension of credit" as "a bank's direct or indirect advance of funds to or on behalf of a borrower based on an obligation of the borrower to repay the funds or repayable from specific property pledged by or on behalf of the borrower."[14] NAR argues the OCC's letter permitting a national bank to invest in windmill farms does not comport with these regulations.

The OCC has also adopted regulations concerning national bank investment in real estate that is necessary for the transaction of its business.[15] Accordingly, a national bank may invest in the following types of real estate:

- Real estate that the bank occupies as bank premises.
- Real estate acquired and intended, in good faith, for use in future expansion.
- Parking facilities.
- Residential property for the use of bank officers and employees who are:

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[9] *Id.* With OCC approval, the five year holding period may be extended for up to an additional five years if the bank has made a good faith attempt to dispose of the property or if disposal within the five year period would be detrimental to the bank.
[10] 12 U.S.C. § 371d. The limit is increased to 150 per cent of capital for banks that are "well-capitalized" and possess a high CAMEL (*i.e.*, supervisory) rating of 1 or 2.
[11] *Union National Bank v. Matthews*, 98 U.S. 621, 626 (1879).
[12] 12 C.F.R. Part 34.
[13] 12 C.F.R. § 34.3(a).
[14] 12 C.F.R. § 32.2(k).
[15] 12 C.F.R. § 7.1000.

  - o located in remote areas where suitable housing at a reasonable price is not readily available; or
  - o temporarily assigned to a foreign country, including foreign nationals temporarily assigned to the U.S.
- Property for use of bank officers, employees, or customers, or for the temporary lodging of such persons in areas *where suitable commercial lodging is not readily available*, provided that the purchase and operation of the property qualifies as a deductible business expense for Federal tax purposes.[16] (emphasis added)

OCC regulations also set out the procedures governing OCC review of applications from national banks to invest in bank premises.[17] The regulations define bank premises as:

- Premises that are owned and occupied (or to be occupied, if under construction) by the bank or its subsidiaries.
- Capitalized leases and leasehold improvements, vaults, and fixed machinery and equipment.
- Remodeling costs to existing premises.
- Real estate acquired and intended, in good faith, for use in future expansion.
- Parking facilities that are used by customers or employees of the bank, its branches, and its consolidated subsidiaries.[18]

OCC's December Rulings Go Beyond "Bank Premises"

The OCC has issued numerous interpretive letters and decisions regarding the authority of national banks to acquire real estate for use in the banking business. The OCC has consistently stated that "[t]he key point is that a bank must hold the property for banking premises and not for real estate speculation."[19] NAR adamantly maintains the OCC's December 2005 real estate rulings violate this principle.

[16] 12 C.F.R. § 7.1000(a)(2)(i)-(v).
[17] 12 C.F.R. § 5.37.
[18] 12 C.F.R. § 5.37(c).
[19] OCC Interpretive Letter No. 758 at 4 (April 5, 1996).

The Hotel Interpretive Letter

In December 2005, the OCC concluded that a national bank was permitted to develop a [luxury] hotel to provide lodging for the bank's out of area visitors under the guise of "bank premises."[20] In the bank's request for permission to develop this real estate project, it stated that the purpose for building the hotel, which NAR subsequently learned is a Ritz-Carlton hotel, was to reduce its annual lodging expense for bank visitors and to "improve the overall quality of [the] experience" for bank visitors.

The hotel would have approximately 150 rooms, and the bank indicated that approximately 37.5 percent of the rooms (only 56 rooms in the hotel) would be used by persons related to the bank's business. The OCC suggests that this level of usage exceeds what has been "expressly permitted in the case law on bank premises."[21] The cases cited by the OCC reveals that the holdings did not involve the banks' level of usage of bank premises. In the first case, *Wingert v. First National Bank of Hagerstown*, a national bank's shareholder alleged that the bank's tearing down of its existing office building and the erection of a new six story office building at the same location exceeds the powers granted by law.[22] The court stated:

> It should be noticed that this is not the case of a national bank about to purchase real estate for the purpose of erecting thereon a six-story building as a business enterprise. In the present case the lot of ground has belonged to the bank since its organization . . . It is therefore simply a question whether or not the bank which is and has been for many years the rightful owner of a lot of ground improved by its bank building can alter and enlarge the improvement on it so as to furnish better accommodation for the business of the bank . . .[23]

The Hotel Letter involves the development of a hotel, which of course is far removed than the erection of an office building on property which was long owned by the bank and on which the

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[20] OCC Interpretive Letter No. 1045 (December 5, 2005) (Hotel Letter).
[21] Hotel Letter at 3.
[22] *Wingert v. First National Bank of Hagerstown*, 175 F. 739 (4th Cir. 1909).
[23] *Wingert* at 741.

bank's building was which already located. Accordingly, NAR believes that *Wingert* does not support the OCC's conclusion.

The OCC cites a second case, *Wirtz v. First National Bank and Trust Company*, which they rely on as recognizing the authority of national banks to occupy space in bank premises and lease excess premises to tenants. As we concluded with *Wingert*, NAR maintains the OCC's use of *Wirtz* to justify the hotel decision is misplaced. The issue decided in *Wirtz* was whether the minimum wage requirements of the Fair Labor Standards Act covered employees of a national bank's subsidiary which operated and maintained a building complex owned by the national bank.[24] While the case stated that the bank occupied 20.7 percent of the total space, contrary to the OCC's statement, there is nothing in the ruling to suggest that it was "recognizing" the bank's authority to occupy the space and lease the remaining space. The court's holding that the act applied to the operating subsidiary's employees cannot in any manner be construed as the court recognizing the authority of a national bank to occupy a certain percentage of space as bank premises since that was not at issue.

The OCC's regulation regarding ownership of property provides that a national bank may invest in real estate if the property is used for temporary lodging in areas *where suitable commercial lodging is not readily available.*[25] The Hotel Letter is devoid of any indication that suitable commercial lodging is not readily available in the area. In fact, NAR's own scan of the area in the immediate vicinity of the bank location reveals a 434-room Marriott hotel directly adjacent to the bank, which also has 20,000 sq ft of meeting space.[26] Interestingly enough, Marriott International Inc. also owns the Ritz-Carlton franchise. The only justification the OCC gives in its interpretive letter is that the hotel will reduce the bank's lodging expense for bank visitors and "improve the overall quality of [the] experience" for bank visitors. This rationale hardly justifies the OCC ignoring its own regulation, specifically the agency's 1996 "temporary lodging" rule providing that national banks may invest in real estate that is *necessary* for the transaction of its business.[27]

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[24] *Wirtz* at 643-644.
[25] 12 C.F.R. § 7.1000(a)(2)(v).
[26] Charlotte Marriott City Center, 100 West Trade Street, Charlotte, North Carolina.
[27] 61 *Fed. Reg.* 4849 (February 9, 1996).

NAR believes that, in order for the OCC to be consistent with their own 1996 "temporary lodging" regulation they should have conditioned approval on the bank's demonstration that commercial lodging is not readily available in the area. Our position is bolstered by a review of the language of the "temporary lodging" regulation and of the regulatory history of the rulemaking in this matter. The rule proposed by the OCC in 1995 provided that a national bank may invest in real estate that is *necessary* for the transaction of its business.[28] Among the types of real estate which the OCC proposed as necessary for the transaction of a national bank's business was commercial lodging *where suitable lodging is not readily available.* The proposal read as follows:

> (a) **Bank Premises-** (1) General. Under 12 U.S.C. 29, a national bank may invest in real estate that is necessary for the transaction of its business.
> (2) Type of real estate. This real estate includes, but is not limited to:
>
> * * *
>
> (iv) Property for the use of bank officers, employees, or customers or for the temporary lodging of such persons in areas where suitable commercial lodging is not readily available, provided that the purchase and operation of the property qualifies as a deductible business expense for Federal tax purposes.[29]

When the proposed rule was adopted by the OCC in 1996, the provision was altered to read as follows:

> (a) **Investment in real estate necessary for the transaction of business-**
> (1) General. Under 12 U.S.C. 29(First), a national bank may invest in real estate that is necessary for the transaction of its business.

[28] 60 *Fed. Reg.* 11924, 11934 (March 3, 1995).
[29] Proposed § 7.100(a)(1)(2)(iv). 60 *Fed. Reg.* at 11934.

> (2) Type of real estate. For purposes of 12 U.S.C. 29(First), this real estate includes:
>
> * * *
>
> (v) Property for the use of bank officers, employees, or customers, or for the temporary lodging of such persons in areas where suitable commercial lodging is not readily available, provided that the purchase and operation of the property qualifies as a deductible business expense for Federal tax purposes.[30]

The final rule contains two significant changes from the proposal. The OCC added the caption "Investment in real estate necessary for the transaction of business" in the title to §7.1000 in addition to retaining it in the body of the rule to underscore the importance and significance that a national bank may invest in real property only if it is *necessary* for the transaction of its business. NAR believes the regulation clearly means that it is necessary to provide temporary lodging *when suitable commercial lodging is not readily available.* It would be illogical to conclude that it is also *necessary* to provide such facilities when suitable commercial lodging is readily available. If that were the case, there would have been little reason to adopt the regulation with any restriction at all. Nothing in the Hotel Letter reflects consideration by the OCC of whether suitable commercial lodging is readily available such that the projects are necessary for the transaction of the bank's business. NAR argues that if the OCC desires to permit national banks to invest in hotels, it must, in accordance with the Administrative Procedure Act (APA), solicit public comment on a proposed change to its existing rule rather than expand national bank real estate investment powers by administrative fiat. And until such time when the OCC follows the APA to amend its 1996 "temporary lodging" regulation, we believe the hotel decision remains inconsistent with, and contrary to, the OCC's lawfully promulgated rules.

The Condominium Interpretive Letter

In December 2005, the OCC also determined that a national bank was permitted to develop a mixed-use building that would provide 12 floors of office space for the bank's use, ground floor

[30] 61 *Fed. Reg.* 4849, 4862 (February 9, 1996).

retail and restaurant space, five floors of hotel space (158 rooms) and four floors of condominiums (32 units).[31] The bank's request for approval to develop the real estate project indicated that, *over time*, it expects to occupy *approximately* 25 percent of available office space and 10 percent of the hotel rooms. With regard to the estimated office space that the bank speculated it will eventually occupy, NAR is troubled by the fact that the OCC never questioned or conditioned the approval on meeting a deadline for achieving a certain occupancy goal. In fact, it seems illogical and inappropriate for the OCC to suggest that this transaction is consistent with prior OCC precedents when the bank itself admits that it will occupy only a "small" percentage of the space and will within some unspecified time occupy only 25 percent of the office space. NAR argues that the only way the OCC can conclude that such an open-ended estimation is consistent with prior OCC precedents is by ignoring the law and its own precedents.

If the test the OCC applied were based on the percentage of use or occupancy in determining a national bank's good faith use for banking purposes, we do not understand how it could conclude that an occupancy percentage that is characterized as "small," and an open-ended assertion that the bank will occupy a specified percentage of the premises at some unspecified date constitutes "good faith" use of the premises. Under such circumstances, it appears that the OCC will accept *any* percentage of occupancy as an indication of a national bank's good faith. Accordingly, we must conclude that the OCC does not seriously consider a bank's occupancy percentage when considering bank premises requests.

An activity identified in the Condominium Letter that is of particular concern to NAR is the bank's proposal that in order to make the office space development deal more "economically feasible" it needed to sell the 32 residential condominiums, which are in no way related to the business of a national bank. While we appreciate the bank's statement that their bank-owned residential condominiums would be sold through an unaffiliated real estate broker, it has no force of law because the OCC did not qualify in the interpretive letter that the bank *must use a broker, or that the use of a broker is required as a matter of law* by the National Bank Act or OCC regulations. Instead, the OCC simply acknowledged the bank's intent, which any other national bank could argue, does not establish policy requiring national banks to use unaffiliated

[31] OCC Interpretive Letter No. 1044 (December 5, 2005) (Condominium Letter).

companies to sell their assets. Regardless, NAR strongly believes that there is no basis in law or regulation that permits a national bank to develop and own residential condominiums for sale to the public.

Another concern to NAR about the Condominium Letter is the "economically feasible" catch-all asserted by the bank and seemingly unquestioned by the OCC. To NAR, this sounds as if any national bank can *justify virtually any type of real estate development project* on the basis that the bank's equity investment is necessary to yield the desired economic result. It seems strange to us that the OCC would permit a national bank to breach limitations imposed by the National Bank Act simply to achieve a target return on its investment. NAR firmly believes that by relying upon the rubric that the development of residential condominiums promotes the economic viability of the project, the OCC has opened the door to permitting national banks to engage in *any type of commercial or residential real estate development* so long as the bank can contend that such activities promote the economic success of the project.

The Windmill Interpretive Letter

In a letter to counsel for Union Bank of California, N.A., the OCC considered the bank's request to make an equity investment in approximately 70 percent of a limited liability company (LLC) that would operate a wind energy project.[32] The LLC would purchase wind turbines and interests in real estate needed to generate electricity. The OCC indicated that the transaction was structured as an equity investment rather than a loan in order to take advantage of federal renewable electricity production tax credits. The bank would be repaid in installments consisting of income provided from revenues produced by the project and by the tax credits. The OCC concluded that the equity investment was permissible because it was the functional equivalent of bank financing.

To justify the equity investment, the OCC relied upon a 1999 decision in which it permitted a national bank to establish an operating subsidiary to invest in an entity that would rehabilitate historic structures in order to take advantage of federal rehabilitation tax credits.[33] The OCC

[32] OCC Interpretive Letter No. 1048 (December 21, 2005).
[33] OCC Corporate Decision 99-07 (March 26, 1999).

indicated that, in substance, the transaction was the provision of construction financing which would be repaid from operating income and through tax credits. What the OCC failed to mention is that in the 1999 corporate decision the bank provided construction financing and used the tax credits to reduce the origination fee and interest rate charged on the loan. Moreover, upon completion of the project, the construction loans would be converted to permanent loans. In contrast, the windmill decision does not involve a loan by the bank. The bank would make only the equity investment. The transaction described in the Windmill Letter is substantially different than the facts presented in the 1999 corporate decision and thus, NAR believes it does not support the OCC's conclusion in the Windmill Letter. The OCC also cites a 1998 corporate decision as support for its conclusion, but a review of that ruling reveals that the bank in that transaction also had provided financing in the form of extending actual loans to the borrowers.[34] Moreover, the corporate decision indicates that under the terms of the agreement between the parties, the borrower was obligated to repay the bank the amount advanced plus interest.[35] No such obligation is present in the Windmill Letter.

The OCC has long held that to be regarded as a financing, the borrower must be obligated to repay principal and repayment of principal must be contractually assured.[36]
This principle was reaffirmed in a ruling issued in 2000 in which the OCC stated that "[r]equiring the borrower to repay principal preserves the fundamental nature of the bank's activity, *i.e.*, that of a lender."[37] In addition, the borrower's obligation may not be conditioned on the profit, income or earnings of the business enterprise.[38] NAR contends the Windmill Letter undermines these longstanding principles.

First, the windmill decision does not require the LLC to repay the bank the amount of its investment. This, of course, is inconsistent with the OCC's position reflected in longstanding rulings that to be regarded as a financing, the borrower must be obligated to repay principal.

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[34] Corporate Decision No. 98-17 (March 23, 1998) ("The Bank has extended credit of approximately $320,000 to a limited liability company that owns and operates oil and gas leases . . .")
[35] *Id.* at 3 ("The Bank has advanced funds to the Borrower and would receive repayment of principal plus interest.").
[36] OCC Interpretive Letter No. 244 (January 26, 1982). 1982 OCC Ltr. LEXIS 18.
[37] OCC Corporate Decision No. 2000-02 (February 25, 2000). The decision also provides that "[i]t is necessary that the borrower be obligated to repay principal in order to preserve the nature of the underlying transaction, *i.e.*, making a loan."
[38] 1982 decision. at *3.

Second, the OCC indicates that the bank will receive periodic payments from the revenues produced by the project and tax credits. NAR believes this conflicts with the OCC's position, also reflected in the 1982 ruling, that the borrower's obligation may not be conditioned on the profit, income or earnings of the business enterprise.[39] In contrast, the bank in the windmill matter will be paid solely from project revenues and tax credits. Again, NAR maintains this represents a marked departure from prior OCC rulings.

Furthermore, NAR believes the windmill ruling also conflicts with other OCC precedents. For example, in 1988, the OCC considered whether a national bank could invest in a limited partnership that was organized to invest in entities that would own, operate and renovate real estate. The OCC's interpretive letter stated that while 12 U.S.C. § 29 grants national banks some limited authority to purchase, hold and convey real estate for bank premises and in a debt-previously contracted context "[t]hat limited authority does not include generally owning, operating, and renovating real estate (note that the statute provides no *de minimis* exception)."[40] In that request, the OCC rejected the bank's attempt to characterize the limited partnership interest as nothing more than the "substantial equivalent" of a secured loan with an "equity kicker."[41] For similar reasons, we argue that the OCC's attempt in the windmill decision to treat the bank's investment in the LLC as the equivalent of bank financing fails.

Conclusion

In January, NAR approached the OCC to communicate concerns with the December 2005 decisions. NAR was very clear with our concerns, specifically, that the decisions lay out a roadmap for the continued expansion of national banks to develop and sell commercial and residential real estate. The OCC responded that the decisions contain limits which preclude the consequence we anticipate will be forthcoming. The OCC also indicated to NAR that it fully recognizes the limits associated with the three decisions and will apply them consistently to all national banks. Needless to say, NAR's concerns remain unsatisfied as the OCC has not amended the letters to establish any meaningful limitations on national bank real estate activities.

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[39] *Id.*
[40] OCC Interpretive Letter No. 435 (June 30, 1988). 1988 OCC Ltr. LEXIS 97 at *3.
[41] *Id.* at *4.

In our view, the OCC has opened the door, and all but invited in, national banks to engage in widespread real estate development that breaches the fundamental separation of banking and commerce, as long as they can make an argument that the project constitutes bank premises in some minor way. Such expansion will dramatically increase the risk exposure of national banks and threaten the safety and soundness of the nation's banking system. Accordingly, we ask Congress to urge the Comptroller to reconsider these December 2005 rulings and direct the OCC to cease from taking any future actions that have the intended or unintended result of expanding bank powers to engage in real estate development. NAR also encourages Congress to be vigilant regarding future OCC decisions that violate congressional intent to keep banking and commerce separate.

Thank you for your attention to this matter that is of such great public importance. I will be happy to answer any questions you may have.

Mr. PLATTS. Thank you, Mr. Stevens.
Mr. Yingling.

STATEMENT OF EDWARD L. YINGLING

Mr. YINGLING. Mr. Chairman, members of the subcommittee, I am pleased to present the ABA's views on the three recent letter rulings by the OCC.

There has unfortunately been a lot of misinformation and exaggeration spread about these three rulings. Frankly, there is very little new here, other than applying longstanding policy to today's economy. At the same time, we welcome the opportunity to clarify the situation, and I thank the subcommittee and its staff for the fairness and openness of this hearing process.

First, it is absolutely clear that the OCC is applying longstanding law upheld by the courts. It is worth quoting a 1902, over 100 years old, opinion upheld by the Supreme Court in 1904, and frankly, I think this goes to some of the discussion in the previous panel. This is what the court said in 1902, and still applies: "Nor do we," that being the court, "perceive any reason why a national bank, when it purchases or leases property for the erection of a banking house, should be compelled to use it exclusively for banking purpose. The National Bank Act permits banking associations to act as any prudent person would," any prudent person would, "in making investment in," and they are referring to that bank, "real estate."

The windmill farm letter is also firmly based in law, as shown by the M&M leasing decision in 1977, 30 years ago.

Second, the rulings are in fact quite limited. They do not serve as precedents for broad real estate development or for engaging in commercial activities. Rather, the two rulings interpret what a bank can do with its own property and for its own business, not broad real estate development.

The other ruling involves the functional equivalent of a loan, not engaging in commerce but extending credit. Thus, it is totally inappropriate, we believe, to extrapolate from these limited rulings to imply that they allow broad-scale real estate development and commercial activities.

Importantly, banks have been engaged in these very limited activities for decades, decades, without any problem whatsoever. Last summer, I visited the town in Arkansas where my family is from. I had not been there in a number of years, and I walked down to the town square. Several years ago, the downtown area, like many small towns, was slowly going downhill as businesses moved out to the malls on the highway. I was pleased to see that the downtown had made a comeback, with law office, specialty shops, restaurants and a community theater. At the heart of the redevelopment were the office buildings of two local banks. These were among the newest and biggest buildings, although certainly not very big by city standards.

One of those bank buildings also served as offices for others. Examples could be lawyers, title companies and while I don't remember, perhaps even a realtor. These banks were fortunately not limited to erecting a building only they could use. They built what

made the most economic sense. We have other examples in the appendix to my written testimony.

These banks saved their downtowns. The same can be said in many towns and cities across the country. If these banks had been artificially limited in what they could build, I doubt very seriously they would have built downtown, because of the expense. Frankly, the primary difference between these examples and the letter rulings now under scrutiny is size. The banks covered by the letter rulings are much bigger and so are the buildings. But that makes no difference under the law or the 100 years of precedents. These buildings are designed to make the best economic use, as the law clearly allows, in their downtown city locations. One need only read the OCC's letters to see how these fit into longstanding precedents and how limited the rulings are.

We appreciate the opportunity to set the record straight, Mr. Chairman.

[The prepared statement of Mr. Yingling follows:]

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Testimony of

Edward L. Yingling

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Government Management, Finance, and Accountability

Of the

Committee on Government Reform

United States House of Representatives

September 27, 2006

Testimony of Edward L. Yingling

on Behalf of the

American **Bankers** Association

before the

Subcommittee on Government Management, Finance, and Accountability

of the

Committee on Government Reform

United States House of Representatives

September 27, 2006

Mr. Chairman and members of the Subcommittee, my name is Edward L. Yingling. I am President and Chief Executive Officer of the American Bankers Association ("ABA"). The ABA, on behalf of the more than two million men and women who work in our nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies, and savings banks – makes ABA the largest banking trade association in the country.

Thank you for the opportunity to present the ABA's views on three recent letter rulings by the Office of the Comptroller of the Currency ("OCC"). In each of these rulings, the OCC did what a responsible regulator should do: It applied existing law to today's facts. In so doing, the OCC has made it possible for national banks to continue serving as economic catalysts for communities across America and to meet the changing needs of bank customers within the existing legal framework.

In my testimony I would like to make the following three points:

- First, the OCC acted well within its authority when it approved banks to develop their premises and to engage in a transaction that is the functional equivalent of lending.

- Second, the challenge by the National Association of Realtors ("NAR") to the OCC's actions is misguided and has the potential to harm the vitality of downtowns across America and to impede investments that Congress has sought to encourage.
- Third, bank regulators need the flexibility to respond to a dynamic industry by permitting the industry to evolve within the limits established by Congress.

These points are discussed in further detail below.

1. The OCC acted well within its authority when it approved banks to develop their premises and to engage in a transaction that is the functional equivalent of lending.

Bank premises

The OCC issued two letters last December approving requests by banks to develop their premises in economically viable ways that would address the banks' operational needs. In considering these requests, the OCC applied precedents that have existed for over 100 years.

Congress included in one of the first codifications of statutes governing national banks the authority for a national bank to hold real estate for the conduct of its business. A national bank using this authority must act in good faith, acquiring the real estate for bank use and not for speculation. Having acquired the property in good faith, the bank is authorized by law to use excess space in the real estate in the same way that a prudent person would use such real estate.

This "prudent person" rule has been in place since 1904, the year in which the United States Supreme Court decided the seminal case of Brown v. Schleier. In that case the Court affirmed the opinion of the lower court, which stated –

> Nor do we perceive any reason why a national bank, when it purchases or leases property for the erection of a banking house, should be compelled to use it exclusively for banking purposes. If the land which it purchases or leases for the accommodation of its business is very valuable, it should be accorded the same rights that belong to other landowners of improving it in a way that will yield the largest income, lessen its own rent, and render that part of its funds which are invested in realty most productive.

The court went on to state that "[T]he national bank act permits banking associations to act as any prudent person would act in making an investment in real estate, and to exercise the same measure of judgment and discretion." The OCC's recent approvals of bank petitions to develop bank premises is simply an application of this well-established authority to today's marketplace.

This authority has enabled national banks to serve as the anchor of downtowns in cities and towns throughout America for over a century. Attached to this testimony are three examples – out of the thousands that exist – of banks that have used their premises to revitalize their downtowns. In some instances, a bank deliberately built a larger structure than it needed so that it would have room to grow. In others, a bank acquired the space that was available even though it was larger than the bank's present needs required. In each case, the bank used the extra space productively to attract other businesses, and in the process strengthened the vitality of the downtown.

Frequently, banks will provide space to local charities and governments. Bank buildings also attract other businesses, such as accountants, doctors, lawyers, and even realtors to downtown. In the examples attached, one of the banks turned excess space into a gathering place for the community while another bank provides space to a non-profit Main Street organization. The common thread in all of these is that mixed-use bank buildings are catalysts for economic activity.

When banks construct or acquire their premises, the economics of the transaction often requires that a building be designed for mixed-use purposes. The OCC recognized this when, in one of the letters challenged by the NAR, the OCC permitted a bank to construct a building that would provide office space for the bank and others, as well as providing space for retail activity, hotel rooms, and condominiums. The proposed mix of space was deemed necessary to make the building financially viable. It also was viewed as important to the rejuvenation of the downtown in which the building is to be located.

The OCC has appropriately recognized that a bank has many uses for its premises. For community banks, the needs may center on local banking operations. For banks operating nationwide or

internationally, the needs may include accommodating bank clients and employees traveling on bank business.

The variations may differ but the theme remains the same: Banks need space to conduct their operations and, having acquired space, banks should be permitted to use that space productively. The OCC and courts have clearly and consistently affirmed that banks have ample authority to acquire bank premises and use them just as any other landowner would. The recent bank premises letters issued by the OCC simply apply this time-honored precedent to current facts.

It also is worth emphasizing that banks have been developing their premises for decades without any problems. That is because, despite allegations to the contrary, the authority is in fact very limited and subject to strict prudential limitations.

Functional equivalent of lending

The authority of banks to engage in transactions that are the functional equivalent of lending is equally well settled. Courts for decades have looked at the economic substance of a transaction rather than its form to determine whether a given activity is permissible for insured depository institutions. In the leading case in this area, M & M Leasing Corporation v. Seattle National Bank (1977), the court concluded that a national bank, pursuant to its authority to "make a loan of money on personal security," may enter into leases that are "functionally interchangeable" with a secured loan.

Banks, as a general rule, are not permitted to own non-financial commercial firms, and the ABA strongly supports this separation of banking and non-financial commerce. However, for many years banks have been permitted to take technical ownership as part of a transaction that is carefully structured to be, in effect, an extension of credit. Leasing arrangements are one common set of such examples, although there are many others. When a consumer leases a car, the lender owns it but the lease is generally a substitute for a car loan. Simply put, these types of financings occur all the time.

The OCC frequently has looked through the form of a transaction to its substance and permitted a national bank to take an equity interest in connection with the financing of many types of projects,

including, most recently, a wind energy project. In order for that project to be economically viable, the bank providing the funding needed to take an equity interest in the company that would operate the project. This enabled the bank to use the tax credits to attract capital to the project, tax credits that would have been unavailable to a nonprofit entity.

The financing of the wind energy project in question was, at its core, the functional equivalent of a loan. The equity interest taken by the bank did not affect the underlying fundamentals of the transaction. The OCC supported this conclusion by listing in considerable detail the factors that led the agency to conclude that the project "would be substantially identical to a recognized form of extension of credit." Among the factors considered was the fact that the day the tax credit runs out, the bank's equity interest is required to end. This clearly demonstrates that this transaction is structured as a financing mechanism around the tax credit. Applying M & M Leasing, the OCC concluded that the bank was authorized to engage in the activity, within careful safeguards.

For years banks have taken equity interests in many other projects, including projects to fund historic rehabilitation, low-income housing, and community revitalization. The real owner of the projects frequently is a nonprofit corporation, which has no ability on its own to make use of a tax incentive. For the non-profit to make use of the tax credit, it usually needs to work with a commercial bank, which can use the tax credit to reduce the effective cost of financing to the non-profit entity. In many cases, though, for the bank to qualify for the tax credit, it must take an equity interest in the project. That is to say, to attract additional sources of funding, a loan often will be structured as an equity investment so that a bank may benefit from the tax incentive and the non-profit may receive the funding it needs, often at reduced overall costs.

The results speak for themselves. For example, in 2005, the low-income housing tax credit attracted $7.5 billion in private equity capital. That same year saw over $3 billion invested in community development projects by national banks alone, of which approximately 90 percent was invested in projects for which tax credits were received. The OCC estimates that next year $7 billion will be received in New

Markets tax allocation credits by insured depository institutions. Without the ability to structure loans as equity investments, these results would not be achieved and the Congressional policy objectives would be frustrated.

The OCC's authorization of a national bank to finance a wind energy project is merely another example of the system working exactly as it should. The transaction reviewed by the OCC clearly is consistent with the law and policy established by Congress. In speaking about this approval as well as the two approvals for banks to develop their premises, Congressman Michael Oxley, Chairman of the House Committee on Financial Services, stated that "The actions that the OCC has taken in its authorization letters are reasonable, well within the law, and within precedent."

2. The NAR's challenge to the OCC's actions is misguided. Moreover, it has the potential to harm the vitality of downtowns across America and to impede investments that Congress has sought to encourage.

The NAR has publicly claimed that the three OCC approvals have put our banking system on a path that will lead to a reprise of the savings and loan crisis or another Japanese-style banking meltdown. This rhetoric is misguided.

National banks have only limited authority to invest in real estate or in commercial activities. The relevant statute states that a national bank may purchase, hold, and convey real estate only for the following purposes:

> **First**. Such as shall be necessary for its accommodation in the transaction of its business.
> **Second**. Such as shall be mortgaged to it in good faith by way of security for debts previously contracted.
> **Third**. Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings.
> **Fourth**. Such as it shall purchase at sales under judgments, decrees, or mortgages held by the association, or shall purchase to secure debts due to it.

Even this limited authority for a bank to invest in real estate for bank premises is subject to a number of safeguards designed to ensure that the authority cannot be misused. First, as noted above, any

investment in bank premises must be made in good faith, *i.e.*, for the bank's use and not for the purpose of speculating in real estate. Second, banks may not make investments in bank premises that would exceed a specified percentage of bank capital. Third, a bank must obtain the prior approval of its primary federal regulator under certain circumstances.

Moreover, a national bank may not use a financial subsidiary to engage in real estate development activities that are prohibited for the bank. Congress was very clear in the Gramm-Leach-Bliley Act ("GLBA") that real estate development is ***not*** an activity that a financial subsidiary of a national bank may engage in. Section 121 of GLBA states that "the activities engaged in by the financial subsidiary as a principal do not include ... real estate development or real estate investment activities, unless otherwise expressly authorized by law."[1]

Thus, banks are not permitted to make a business in real estate development. In essence, a bank's authority is confined to holding real estate as bank premises and in connection with making mortgage loans. This hardly places the banking system on the road to ruin. Instead, this limited authority is all about enabling banks to provide the services to their communities that they were chartered to provide.

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[1] The full text of section 121 of GLBA states, in relevant part:

(a) AUTHORIZATION TO CONDUCT IN SUBSIDIARIES CERTAIN ACTIVITIES THAT ARE FINANCIAL IN NATURE.—

(1) IN GENERAL.—Subject to paragraph (2), a national bank may control a financial subsidiary, or hold an interest in a financial subsidiary.

(2) CONDITIONS AND REQUIREMENTS.—A national bank may control a financial subsidiary, or hold an interest in a financial subsidiary, only if—

(A) the financial subsidiary engages only in—

(i) activities that are financial in nature or incidental to a financial activity pursuant to subsection (b); and

(ii) activities that are permitted for national banks to engage in directly (subject to the same terms and conditions that govern the conduct of the activities by a national bank);

(B) the activities engaged in by the financial subsidiary as a principal do not include—

(i) insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death (except to the extent permitted under section 302 or 303(c) of the Gramm-Leach-Bliley Act) or providing or issuing annuities the income of which is subject to tax treatment under section 72 of the Internal Revenue Code of 1986;

(ii) real estate development or real estate investment activities, unless otherwise expressly authorized by law; or

(iii) any activity permitted in subparagraph (H) or (I) of section 4(k)(4) of the Bank Holding Company Act of 1956, except activities described in section 4(k)(4)(H) that may be permitted in accordance with section 122 of the Gramm-Leach-Bliley Act;

* * *

National banks' authority to make an equity investment as part of a transaction that is the functional equivalent of lending is comparably narrow. The National Bank Act prohibits national banks from making equity investments except in a few specified instances. An equity interest taken solely to facilitate a transaction that is the functional equivalent of lending does not cross that statutory line.

As previously noted, the OCC carefully reviewed the wind energy project at issue. It looked at, among other things, the underwriting criteria applied by the bank, the extent to which the bank intended to become involved in the management of the underlying business, and whether the bank could realize a speculative gain or loss. Following this review, the OCC concluded that the wind energy project posed no greater risk to the bank than would a transaction structured as a direct loan. More broadly, the precedent presents no greater risk to our economy than does lending in general.

The NAR is making arguments that threaten banks' ability to continue serving their communities and their customers. As discussed above, banks have provided enormous benefits to towns and cities across America. Downtowns will suffer if banks lack the ability to develop their premises with mixed-used buildings. Without banks' ability to offer innovative financing structures, the ability to achieve the goals that Congress has sought to achieve through tax incentives – in areas such as community development, low-income housing, and renewable energy – will be undermined.

America will be a poorer place if the longstanding bank community investment practices described above become casualties of the NAR's campaign. It is perhaps ironic, but certainly unfortunate, that the ominous phantoms of economic catastrophe conjured up by the NAR could cause real economic harm.

3. Bank regulators need the flexibility to respond to a dynamic industry by permitting the industry to evolve within the limits established by Congress.

The United States has benefited from a remarkably healthy banking industry. The health of that industry is due in large part to a regulatory system that permits banks the freedom to innovate. Congress

establishes the policy that guides our banking industry. Congress also relies on the bank regulators to implement the policy directives in the myriad of situations that banks face every day.

Our banking industry is as dynamic as our economy. As the needs of bank customers evolve, so must the ability of banks to respond to those needs. This, in turn, requires a regulatory system that is sufficiently flexible to permit safe, sound, and innovative ways of meeting customer needs.

We urge Congress to permit the regulators to continue doing what they do best, namely, rigorously apply safety and soundness principles in an environment that permits banks to grow and serve their communities.

CONCLUSION

The OCC, in issuing the three letters that are challenged by the NAR, acted responsibly and in a manner that is consistent with applicable statutes and court cases. Despite breathless rhetoric to the contrary, the letters are very limited in scope. Certainly, and in fact obviously, they will not cause the downfall of our banking system or erode the boundaries between banking and non-financial commerce. Rather, the letters will permit banks to continue serving as economic catalysts for their communities and as creative sources of capital for their customers.

Attachment

First National Bank headquarters in Waverly, Iowa

1

First National Bank in Waverly, Iowa

Restoration and Revitalization

A view of main street in Waverly

Cedar Falls Financial Center is located next to the public library and community center, which are also civic improvements.

This 142-year-old main street bank invested in both new construction and renovation to provide office space for their own company operations along with space for unaffiliated businesses in both Waverly and Cedar Falls, Iowa. It has also made major equity investments in a state program for low-and-moderate income housing. The bank's projects contributed in a major way to the overall main street improvements that were occurring in both communities.

"What we've seen is, if we are willing to invest in our communities, other good projects usually follow from other parties," said Jeff Plagge, president and CEO, First National Bank, Waverly, Iowa. "It shows leadership and a commitment to our downtowns and our communities. At the same time it gives other parties the confidence to then make their own investments."

"There's definitely been a lot more investment in downtown Cedar Falls since we finished our project."

In the bank's headquarters town of Waverly (population 9,500 in a county that totals 24,000) they built a two-story office building, with a lower level, right next to the bank. The lower level of the building houses the company-related account processing, data processing, compliance, audit and human resources activities and staff. The main floor houses an independent insurance agency that is a subsidiary of the bank's holding company. Half of the second floor is a large conference and training room for the bank and the agency and the other half is leased out to two nonaffiliated companies.

"It was a very strategic decision," Plagge said. "We wanted to be part of the downtown community. By adding a second floor, we would have potential space for future use. However, in the meantime, it was an opportunity to lease the extra space to two unaffiliated companies that expressed an interest in our project. It was a very strong commitment to downtown and one that has received very favorable comments."

The bank also gave back to the city a tax incentive that it could have used for itself, so that the city could use those funds to dramatically upgrade a public parking lot in the middle of downtown to benefit all of the businesses there.

Seventeen miles away in Cedar Falls (population 90,000) the bank took a different approach when it faced the need to grow. It bought an old main street grocery store that had recently closed. If the bank had simply torn it down and built a new office, it would only have needed about 11,000 square feet. However, it was more economical to buy and renovate the old 17,000 square foot store, reserve the extra space for potential growth of the bank, and in the meantime provide first-class office space to other businesses. These now include an accounting firm and the non-profit Cedar Falls Main Street Organization. The facility is located right next to two new civic improvements, namely a public library and a community center, all of which have come together to ignite even more new life in the downtown area.

"When you added our project and the city of Cedar Falls' public library and community center, to what was already going on in downtown Cedar Falls, you truly had a community that was on the move," Plagge said. "There's definitely been a lot more investment in downtown Cedar Falls since we finished our project."

First National Bank has extended its reach to other parts of the state by making two investments in the Iowa Equity Fund. This fund uses tax credits to renovate existing, rundown facilities into comfortable, modern housing for low- and moderate-income people. By taking equity interest in the Iowa Equity Fund projects the bank is able to qualify for the tax credits.

"It's basically taking eyesores and rundown buildings and putting them back into useful purposes at affordable prices for people who need housing," Plagge said.

Home Savings Bank in Kent, Ohio

2

Bedrock of Downtown

Home Savings Bank, prominent in this university town of 30,000 people (including 22,000 students) for 108 years, continues every day to bolster the area's general economy and cultural richness.

Still headquartered in what was originally a hardware store in a commercial building built in 1889 that the bank moved into in 1898 — now remodeled five times — Home Savings Bank offers the largest and best general office space in downtown Kent. Anchored at the corner of Main and Water Streets, the bank does a lot to hold together a commercial area beset by big-box retailers located elsewhere.

"For a community bank to be a community bank, you have to be in the community. And always, the best place to be is on the No. 1 corner in the heart of downtown," said Howard Boyle, president and CEO, Home Savings Bank, Kent, Ohio.

The bank leases most of the second floor of the two-story building to various professionals and businesses — two attorneys, an architect, a doctor, a chiropractor, a trucking coordinator and an information technology company. The first floor, in addition to the space the bank requires, is leased to a coffee shop and a barber shop.

"The community just loves it. It's a beautiful, beautiful site," Boyle said. "The fun thing about that, from having [Home Savings Plaza] completed and looking so nice, the rest of the downtown has started to look so much better."

The bank deliberately renovated a facility that's bigger than its current needs as a cushion for possible future growth.

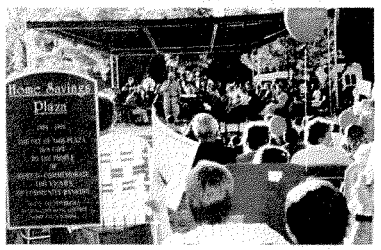
"Always in the back of our minds was the need for expandable space," Boyle said.

It's also one of the last remaining buildings of its kind in Kent. Four years ago, a savings and loan moved out of a building across the street from Home Savings and now operates strictly in the suburbs. In its place is an entity that pays no taxes and does not attract the clientele vital to an active commercial district.

Home Savings Bank bought a long-vacant lot next to the bank and transformed it into a park with an open-air stage

Home Savings Bank has gone the extra mile for its community. It bought a long-vacant and unattractive lot next door and, on the occasion of the bank's 100th anniversary, dedicated a newly remodeled, flower-bedecked park with an open-air stage on that lot. Summer evening outdoor movies, ice cream socials, cider festivals and all sorts of concerts — all helpful in energizing downtown Kent — are held at what's now universally known as Home Savings Plaza.

HOME HERITAGE CONCERT



A summer concert at Home Savings Plaza

"The community just loves it. It's a beautiful, beautiful site," Boyle said. "The fun thing about that, from having [Home Savings Plaza] completed and looking so nice, the rest of the downtown has started to look so much better."

For example, hanging potted plants now grace many of the streetlights. Also, community groups, volunteers and individuals have signed up to "adopt-a-spot," pledging to keep designated places clean, watered and planted.

"I always say the nice thing about downtown Kent is that it's such a beautiful place to work and do business in," Boyle said.

3

SpiritBank in Bristow, Oklahoma

Center of Commerce

Within the triangle formed by Tulsa, Oklahoma City and Stillwater, SpiritBank operates 18 branches, each of which plays an essential role in helping meet the financial needs of the people and businesses of the area.

SpiritBank headquarters in Bristow, Oklahoma.

Drumright branch and vocational-technical school

Business resource center in Tulsa

The bank established its headquarters in the town of Bristow (population 5,000) by replacing blighted housing units with a new building on Main Street. With an eye towards expansion, the bank initially built more space than it needed and leased the excess space to several attorneys.

"As far as putting a new face on the town, that by itself was an enormous investment," said Kell Kelly, president and CEO, SpiritBank, Bristow, Okla.

But hardly the only such investment. Up the road a piece, in the town of Drumright (population 3,000), SpiritBank came in and bought a failed bank there which, along with a vocational-technical school, represented the town's only economic vitality. The bank moved into a building occupied by a previous bank and a three-story building that had been built years before when oil still held sway in the area.

"We took what was offered. The facilities were as the facilities were," Kelly said, acknowledging that at the time they were much larger than the bank actually needed. But rather than let the space sit idle, the bank worked to use that space to benefit the community.

In short order, the town's chamber of commerce leased space there. The bank offered space for a common-use meeting room. And, working with the city leaders and recognizing the need to spur employment, the bank leased space to a major rent-a-car company's reservation service.

The bank didn't stop there. In the town of Cushing (population 8,500), SpiritBank bought yet another failed bank branch, renovated the premises and opened up office space to an attorney firm, a title and closing company, and an insurance agency.

"We've shown that we are a community partner that is willing to put dollars into developing the economies of these towns."

The bank has not ignored the bigger cities either. In Tulsa, SpiritBank hosts what it calls a "business resource center," and it plans to do the same thing in Oklahoma City. By design, the building in which the bank's branch operates also offers unaffiliated services that are complementary to banking. These include business resource professionals, strategic planners, process planning experts, attorneys and accountants. At the same time, through demolition of unsightly adjoining buildings and sprucing up of the surrounding grounds, SpiritBank was instrumental in revitalizing Tulsa's downtown area.

The bank's beneficial investment influence also is seen in its experience in putting together federal and state tax credits in order to attract major new employers to the state. For example, at almost the same time that a long-time lock manufacturer moved its operations to Mexico, the bank was able to convince an international aerospace company to establish a major, permanent presence in rural Oklahoma — bringing with it hundreds of quality, high-paying jobs. By providing funding to the aerospace company in the form of an investment, the bank was able to benefit from the New Markets tax credits.

"We've shown that we are a community partner that is willing to put dollars into developing the economies of these towns," Kelly said.

Reject the NAR campaign.
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Bank Buildings Help Communities

NAR Campaign Threatens Local Economic Growth

The National Association of Realtors (NAR), in a well-funded public campaign, has attacked long-established practices of banks that have provided enormous benefits to towns and cities across America. These practices have been authorized by regulators for decades. But now the NAR would threaten that sound and sensible authority, and would deny any bank the ability to make the best use of its own office buildings or to provide funding for projects that Congress has encouraged.

Courts have allowed banks for over 100 years to use excess capacity in bank buildings to provide space both for local businesses and for the banks as they grow along with their communities. Mixed-use buildings often serve as the core of efforts to revitalize the downtowns of communities large and small, providing space for doctors, dentists, accountants, pharmacies, barber shops and even Realtors.

Banks also often take narrowly targeted equity interests in property — as part of transactions that are carefully structured to function much like loans — in order to attract capital to support government-favored purposes. This long-standing authority enables banks to bring together funds that leverage low-income housing tax credits, New Markets tax credits, historic rehabilitation tax credits, and renewable electricity production tax credits.

Approvals of these activities have been routine and uncontroversial. The NAR campaign endangers these long-standing community investment practices. If these practices were the casualties of the NAR, significant economic growth and development would be lost — and our communities and citizens would suffer.

We present three examples that illustrate the importance of these practices for communities and citizens. Each bank built or renovated a structure that is an anchor of the bank's downtown — and the banks' investments continue to provide many benefits to the community. These stories are not unusual — there are many more in towns and cities throughout America.

The NAR rhetoric risks rolling back the authority for —

- **Banks to develop their premises in ways that make economic sense for the banks and revitalize their communities**
- **Banks to meet the credit needs of their customers by making investments that function like loans**
- **Regulators to adapt to a changing economy by permitting banks to make investments that are safe, sound and innovative**

SEE THE CASE STUDIES

Mr. PLATTS. Thank you, Mr. Yingling.
Ms. Shelton.

STATEMENT OF CYNTHIA C. SHELTON

Ms. SHELTON. Thank you, Chairman Platts, Ranking Member Towns, Chairman Davis and my friend Mr. Kanjorski, for allowing me to be here to speak with you today.

My name is Cynthia Shelton and I am a practitioner and commercial real estate broker with the firm of Colliers Arnold in Orlando, FL. I have been in the real estate business for 32 years. Commercial real estate professionals help clients with all aspects of commercial real estate needs.

In the case of real estate development, commercial real estate professionals help clients locate properties, work with them and a financial institution to create the most suitable financing plan available, find tenants that would occupy those spaces and many times in helping them sell the projects once they are completed.

Commercial real estate professionals provide these services with the knowledge and unique understanding of the economic health and sometimes high risk of developing real estate projects in local markets. The OCC's decision in expanding the authority of banks to develop real estate undermine the ability of the commercial real estate professional to work with a financial institution on a level playing field and further blur the lines that distinguish banking from commerce.

I have always understood that a key purpose of the national policy against mixing banking and commerce is to protect banks from the inherent risks posed by a commercial venture. Banks strive to maintain soundness and stability by managing their risks, keeping sufficient reserves and diversifying their loan portfolios. In determining a potential loan, the bank evaluates the strengths of the developer's business plan and their overall assessments of the risks that the loan would pose.

There is an implicit acknowledgement that the borrower-developer assumes the risk of the venture and the venture's ultimate failure or success, and the bank must ensure that its soundness won't be unduly jeopardized by that risk, or that the borrower-developer has personally signed and has sufficient assets to cover that risk.

The OCC's recent rulings complicate that mutual beneficial relationship by allowing banks to compete in the business of real estate development. Could a bank change its lending criteria to favor a potential development deal in which it has stake over another one, which it doesn't? What would prevent a bank from taking advantage of the business plan of a sound commercial real estate venture that applies to that bank for financing?

I can't believe that the OCC envisioned these scenarios, but I do not see anything that would present this from happening. I am concerned that the OCC may have considered the potential impact of these decisions on a bank's ability to act as an honest broker of financial services.

We believe that Congress requires the separation of banking and commerce also for the consumer's protection and to enhance the safety and soundness of the banking system. I had personal experi-

ence with these issues when the separation was breached during the devastating savings and loan crisis of the 1980's. Then many savings and loans were permitted to invest in real estate developments and to make commercial real estate loans with little regard to sound risk management practices, such as the understanding of the local commercial markets and their changes.

Thankfully, because of new laws, strong underwriting standards and risk management practices, we believe a repeat of the late 1980's and the days of the RTC is highly unlikely. Though the commercial real estate markets have been strong as of recent on a national level, I remind you that it is like a giant quilt made up of local markets that can vary significantly and shift fairly easily. When a bank is permitted to develop real estate, the bank does so in a localized real estate market. And because we are real estate professionals, we know first hand how fast the local markets can change. Banks should not be permitted to impair their safety and soundness by assuming the high risk of a commercial real estate development.

How many other national banks will engage in these real estate development activities tomorrow? How many banks will choose to get into the risky commercial real estate ventures in the weak local markets because of their easy access to cheap capital through federally insured deposits? How far will the OCC go in granting this unfair business advantage to the banks? Let's hope we don't have to find out.

In conclusion, we ask Congress to urge the OCC to curb the ability of banks to develop commercial real estate, so that the distinction between banking and commerce is not diminished further, and that the commerce of real estate is not undermined.

Thank you for allowing me to testify, and I am open to any questions you may have.

[The prepared statement of Ms. Shelton follows:]

Statement of Cynthia Shelton, CCIM, CRE
on behalf of the REALTORS® Commercial Alliance

Hearing before the House Government Reform
Subcommittee on Government Management, Finance and Accountability
on
Office of the Comptroller of the Currency's Decisions
to Allow National Banks to Engage in Real Estate Development,
Ownership and Merchant Banking
September 27, 2006

Thank you Chairman Platts, Ranking Member Towns and members of the Subcommittee for inviting me to testify today on the impact of the Office of the Comptroller of the Currency's (OCC) rulings expanding the authority of banks to develop real estate on the commercial real estate industry. My name is Cynthia Shelton and I have been in the real estate business for 32 years. In 2002 I was honored to be the CCIM[1] Institute International President, a 17,000 member commercial investment organization. I am a commercial real estate investment broker with the firm of Colliers Arnold in Orlando, Florida and also serve as a liaison to the National Association of REALTORS'® Leadership on commercial issues.

I am pleased to testify on behalf of the REALTORS® Commercial Alliance which represents the Institute for Real Estate Management (IREM), the CCIM Institute, the Society of Industrial and Office Real Estate (SIOR) and the REALTORS® Land Institute (RLI). Together, members of the REALTORS® Commercial Alliance are involved in all aspects of commercial real estate – from real estate brokerage to property management.

Overview of the Commercial Real Estate Markets and the Commercial Real Estate Profession

Commercial real estate is powerful engine of the national economy. It is where Americans shop, work, live and play. The health of the commercial real estate market generally mirrors that of the overall economy. However, it is best to look at commercial real estate as a quilt of local markets and submarkets, each susceptible to localized economic trends. Today's U.S. commercial real estate is worth approximately $5 trillion, and includes 4 billion square feet of office space, 13 billion square feet of industrial property, 6 billion square feet of shopping center space, 4.4 million hotel rooms, and 33 million square feet of rental apartment space. America's 48,695 shopping centers account for $2.12 trillion in sales in 2005 and generated $114.4 billion in state sales taxes. And, the nation's multifamily housing provides homes for over 23 million households. Commercial real estate professionals navigate this quilt, with its patches of unique markets, to help clients make the best real estate decisions.

NAR's over 50,000 commercial members help clients with all aspects of their commercial real estate needs from negotiating leases on behalf of a retail or office client and negotiating a sale to an institutional investor to providing property management services. In the case of real estate development, commercial real estate professionals will help clients 1) locate an appropriate site,

[1] Certified Commercial Investment Member Institute

2) work with clients and financial institutions to create the most suitable financing plan, and 3) find suitable tenants for the space being developed. Commercial real estate professionals use their unique understanding of the economic health and risks of the local economy in providing these services. The OCC decisions expanding the authority of banks to develop real estate undermine the ability of commercial real estate professionals to work with financial institutions on a level playing field and further blur the line that distinguishes banking from commerce.

Impact of the OCC's Decision on the Commercial Real Estate Profession

As a commercial real estate professional who has developed close working relationships with large banks, I am concerned that the decisions by the OCC will compromise their ability to act as honest brokers of financial services. Now when I negotiate a transaction with banks and clients, I must ask myself, am I dealing with a financial service provider as part of a team or a potential competitor?

I've always understood that a key purpose of the national policy against mixing banking and commerce is to protect banks from the inherent risk posed by any commerce venture. Banks, because they have a duty to protect the savings of their depositors, and because their deposits are insured by the FDIC, strive to maintain soundness and stability by managing their risk, keeping sufficient reserves, and diversifying their loan portfolio. The terms of the loans banks make to commercial real estate development reflect their assessment of the risk associated with the venture in the context of the bank's overall soundness. In conducting their due diligence analyses, banks evaluate the strength of the business plan in their overall assessment of risk the loan poses to the institution. There is an implicit acknowledgement that the borrower assumes the risk of the venture's ultimate failure or success, and the bank must ensure that its soundness won't be unduly jeopardized by that risk.

The OCC's recent rulings complicate that mutually beneficial relationship by allowing banks compete in the business of real estate development. Could a bank change its lending criteria to favor a potential development deal in which it has a stake over another in which it doesn't? What would prevent a bank from taking advantage of the business plan of a sound commercial real estate venture that applies to the bank for financing? I can't believe OCC envisioned these scenarios, but I do not see anything that would prevent this from happening. I am concerned that the OCC may not have considered the potential impact of these decisions on a bank's ability to act as an honest broker of financial services.

It is important that Congress monitor the efforts that the Department of the Treasury and the OCC undertake to keep banks "honest brokers" in providing financial services, and to ensure that they do not become competitors of real estate brokers and agents and other commercial firms.

Importance of the Separation of Banking and Commerce to Commercial Real Estate

We believe that Congress requires separation of banking and commerce also for consumer protection and to enhance the safety and soundness of the banking system. I had personal experience with these issues when the separation was last breached during the devastating Savings & Loan crisis of the 1980s. Then, many Savings and Loans were permitted to invest in real estate developments and to make commercial real estate loans with little regard to sound risk

management principles -- such as an understanding of the local commercial real estate market. The historic collapse of the Japanese banking system of the 1990s is another example of the kind of problems that arise when banking and commerce mix. These examples remind us of the potential dangers and the unintended consequences of mixing banking and commerce. Thankfully, today because of new laws and strong underwriting standards and risk management practices, we believe a repeat of the late 1980s is highly unlikely.

The OCC decisions permit U.S. national banks to engage in the business of real estate development by developing and operating a luxury hotel; financing, developing, operating and leasing space in a mixed use building (including developing residential condominiums for sale). They need only argue that a small portion of the project is needed for bank premises or that a part of the project is needed to make the rest economically feasible. They may also hold a 70 percent equity stake in a windmill business, qualifying for special tax credits. Three national banks were given the green light to engage in these business activities. We can understand that banks may want to develop office space to house their operations. However, when banks are permitted to develop real estate where there is no direct relationship with their operations, and assume the risk of identifying office tenants, entering into lease arrangement with a large hotel chain, and selling condominium units, we feel that the line distinguishing banking and commerce has been crossed. The banks will have assumed the direct risks of success or failure – risks that have traditionally been borne by those engaged in the commerce of commercial real estate.

Conclusion

Though the commercial real estate market is strong on a national level, I remind you that the market is a giant quilt made up of local markets that can vary significantly and shift fairly quickly. When a bank is permitted to develop real estate, the bank does so in a specific localized commercial real estate market – and because we represent real estate professionals, we know first hand that each market carries its own unique set of risks that may one day jeopardize the success of that development. Banks should not be permitted to impair their safety and soundness by assuming the risks of commercial real estate development.

How many other national banks will engage in these real estate development activities tomorrow? How many banks will choose to develop risky commercial real estate ventures in weak local markets because of their easy access to capital? How far will the OCC go in granting this unfair business advantage to banks?

Let's hope we don't have to find out. We ask Congress to urge the OCC to curb the ability of banks to develop commercial real estate so that the distinction between banking and commerce is not diminished further, and the commerce of real estate is not undermined. Thank you for allowing me to testify before you today. I welcome any questions you may have.

Mr. PLATTS. Thank you, Ms. Shelton. I would like to recognize the chairman of the full committee, Mr. Davis, for purposes of questions.

Chairman TOM DAVIS. Thank you, Mr. Chairman. I have people waiting in my office, so I need to get up there, but I want to just ask, do you know how many letters are put out a year on this subject? Anybody have any idea? I should have asked the previous speaker. These three, I think because of the magnitude, and maybe the facts on the ground don't match the facts that were perceived in the letter, have generated more controversy. Does anybody know how many letters?

Mr. YINGLING. I don't know. We can get you that number. I think it is kind of a slow trickle on this subject. There are letters, interpretive letters all the time. I think one of the disconnects we may have here is that these letters were seen within the banking industry as non-events. And I think some people to my left and right and some Members of Congress see them as big events.

But to put it in perspective, we have had 800 new regulations in the last 15 years. That is one a week. We constantly are going to our regulators, formally and informally, on an ongoing basis, asking for their feedback. We get informal feedback, we get informal letters. So in the broad context, from our industry, these were seen as very, very minor events that would have buried had they not been brought up.

Chairman TOM DAVIS. Even prior to this, there has been some controversy in terms of how the OCC may interpret this, correct?

Mr. YINGLING. This issue?

Chairman TOM DAVIS. Yes.

Mr. YINGLING. No.

Chairman TOM DAVIS. You don't think so?

Mr. YINGLING. No, sir.

Chairman TOM DAVIS. Do you feel, let me just ask, and I will start with you, Mr. Stevens, on the notice requirements, when a letter like this comes up, do you think there ought to be a broader notice or do you think you just ought to have somebody write and kind of have the ex parte communication over what the project is and let the decisionmaker make it? How should this work and do you feel in this particular case the notice provisions weren't adequate?

Mr. STEVENS. I definitely think that the notice, as described earlier, that it should be broadened, it should be heightened. Because we had a member that I think saw it on the Internet somewhere and notified us in January, almost a month after the letters were issued. And a news reporter in New York brought it to our attention at about the same time.

So I don't think it is, the exposure or the notification process is significant enough when you are talking about the possibly of changing Congress, a decision that Congress has made. That is why we are involved in this. We think that is an important policy question, a serious policy question, that has the OCC gone too far. When they are making decisions and you can't find the notification of these decisions, that is a challenge.

Chairman TOM DAVIS. Do you feel better or worse after hearing the OCC testify? I guess I would ask everybody that.

Mr. STEVENS. Well, I think it is real clear that there are some challenges here, that I still feel that they have overstepped their bounds. I think they have gone too far. When you start to look at the rationale that they are using to approve this real estate development, nowhere in any law that I have seen does it allow you to build speculative condominiums. Is it really a Ritz Carlton that is going to help fulfill the banking needs, a speculative hotel that is going to be used very little, truly, by the bank, or its employees or its clientele, when you get down to it? It is a challenge.

Chairman TOM DAVIS. Mr. Yingling, you think it is a non-event, basically, is that right?

Mr. YINGLING. Yes. First, back to your first question, I am informed that Ms. Williams' testimony says there were 22 letters in roughly 30 years in this area.

Chairman TOM DAVIS. On this subject.

Mr. YINGLING. I will tell you why I think it is a non-event. Go to any town, any city, any big city in the country, and go downtown. Quite often you will see at the heart of the downtown bank buildings. Go to the areas in your district that are the key areas. You will see major buildings, depending on the size, relatively major buildings, with a bank name on them. They are bank buildings. By and large they are owned by the bank.

Very, very many of those buildings are not fully used by the bank. It has been that way always. They build the buildings, they look at what they may need, they play ahead and say, we may grow, so we need extra space. Sometimes they say, well, in order to build in this position, I need to do some other things with that building. And sometimes, frankly, they are trying to, very often they are trying to help save a downtown or build enough of a critical mass downtown to have a good downtown.

It has gone on for 100 years. It has never been a problem. That is why from our perspective, while these were applying old law to new facts, we didn't see it as a big deal at all. And nobody in the industry has come to me as the president of the ABA and said, wow, what a great opportunity this is. Nobody has come to us about it, because it is seen as just part of a continuum.

Chairman TOM DAVIS. Mr. Stevens.

Mr. STEVENS. Can I just respond? I want to make it real clear, NAR has no problem with banks building buildings to accommodate their business. I don't know if you saw the Metro section of the Washington Post this morning, but the lead column is where a major developer of a condominium in Bethesda, Maryland, has pulled out of that project. And with a market changing like this, when you start to deviate from your core competency, and I think banking is banking, and commerce is commerce, I think when you start to deviate from your core competency, you are going to end up in trouble. We have seen that before with savings and loans. That is why I think they have overstepped their bounds.

Mr. YINGLING. These buildings I am talking about, there are a large number of them that you see in every town and city, have significant percentage of it that is not used for banking purposes. That has been the way they have been built all along. They sometimes go and buy old buildings that are falling down, refurbish them down in these small towns.

Chairman TOM DAVIS. I gather there is no problem with that scenario, it is when you get into the larger scenarios——

Mr. YINGLING. No.

Chairman TOM DAVIS [continuing]. I guess everybody——

Mr. STEVENS. We support the current statutory authority to allow banks to invest in community and economic development. That is a whole different issue.

Chairman TOM DAVIS. And even a bank building can be used for other, is that right? OK, thank you both.

Mr. PLATTS. Thank you, Mr. Chairman.

Mr. Yingling, in your opening you said that this is all about mis-information and exaggeration. What are examples of the mis-information and exaggeration?

Mr. YINGLING. I think the thing that most concerned us was some of the rhetoric that came out early on and is still used from time to time. You hear references to the savings and loan crisis as thought this somehow or other is going to lead to some kind of major crisis in our banking system. We think that is completely uncalled for.

We as an industry are on the record that we don't want to be in the real estate development business. There is a provision in Gramm-Leach-Bliley that says we can engage in financial services and there are two exceptions. One of them is explicitly real estate development. We supported that provision. We have no desire to be in real estate development. But to use language that somehow or other this is going to develop into major involvement of banks and real estate development we think is just a gross exaggeration. We think it is a very limited, targeted provision.

Mr. PLATTS. As a lay person looking at the project, and I will take the PNC project, which again, as Paul said, we want PNC to succeed, they are a very large employer in our State. But as a lay person looking at that project, office space, hotel, condos, wouldn't a lay person look at that and say, that is a great real estate development project?

Mr. YINGLING. I think that is a fair point. I think you have to go and look at the history of it and look into what PNC is doing there. They have two office towers in downtown Pittsburgh that are fully used by them, and they have people around the city, their employees, in buildings that are not part of their core. Naturally, they want to get them back to the core, and these leases are expiring.

Naturally, they also, this is a very vibrant institution that is growing, they need to plan for growth. So it is natural for a business to say, I am not just building a building that is going to fit me today, I want the opportunity to fit my growth into that building. So they are taking a run-down piece of property, as I gather, that they own, and they are developing it.

Now, having made that decision, the current law is, and I am going to separate that from your view of what it ought to be, the current law, and I just read you the relevant court case, 100 years old, is quite clear. They are allowed to develop that as long as it is basically, at its core, done for banking. They are allowed to develop it as anybody else would.

Mr. PLATTS. Do you think the Supreme Court justices in 1902 or 1904, in the opinion, would look at the hotel and say that is a banking service?

Mr. YINGLING. That is not the standard.

Mr. PLATTS. No, but as you are saying that it s core to their banking operation.

Mr. YINGLING. No, that is not the standard. The standard is when they are starting the building is, are they building a building to have something that is core to their business. Once they start that, the rest of the building doesn't have to be core to their business. They can develop it as any prudent man. That is the standard.

Mr. PLATTS. OK, let's not use Pittsburgh as an example. Bank of America built a hotel, not office space for the bank, built a hotel. How is that banking operation?

Mr. YINGLING. If you go back and look for dozens and dozens of years at the precedent, and they are very limited things that you can do, one of them is housing your employees.

Mr. PLATTS. But the OCC has said, if there are no other reasonable options——

Mr. YINGLING. I am sorry, that is not the standard.

Mr. PLATTS. Isn't that what the law says?

Mr. YINGLING. No. Julie Williams explained it, and that is what was just said in the testimony, she explained it, that was one of the included standards. It is not an exclusive standard. It says "including."

Mr. PLATTS. No, but the real estate, for the temporary lodging, but the first part of that standard is, let me read it: "A national bank may invest in real estate that is necessary for the transaction of business." If there are two hotels right there, that goes to, the first question is, is it necessary. If it is, then it allows, this type of real estate. You are looking at the second part of the rule.

Mr. YINGLING. Well, I will get back to you on it, but I don't think that is the correct, that you are articulating, frankly, the correct standard.

Mr. PLATTS. Well, I am reading, I believe, straight from the rule, that it says, a national bank may invest in real estate that is necessary for the transaction of business. Then it goes on to talk about, lists the types of real estate that are allowed.

Mr. YINGLING. Right. Then you are going back to the word necessary. And I just agree with Julie Williams' discussion there on what the word necessary means and the history of it.

Mr. PLATTS. Well, let's go back to the court case and where you started, I think that is a good place to start. It says, "Nor do we perceive any reason why a national bank, when it purchases or leases property for the erection of a banking house, should be compelled to use it exclusively for banking purposes."

Mr. YINGLING. Right.

Mr. PLATTS. Building a hotel is not "purchasing a property for the erection of a banking house." So if I am looking to distinguish that case, very quick I am saying, they didn't buy this building or this property to build a banking house. They bought it to build a hotel. Why is that not significantly different than that court case?

Mr. YINGLING. Then you get to, when you get there you get to the issue of whether the hotel they are building is part of the banking business.

Mr. PLATTS. Is a banking house?

Mr. YINGLING. Yes, I agree with that. That is different from PNC, where you are adding the hotel onto a bank office.

Mr. PLATTS. And that is the challenge here. There are a lot of issues here. But PNC, I think they make a stronger case. Office space for their own bank, they can expand. But when you go to the windmill, when you go to the hotel, you look at the language of that case, that is the controlling part of that opinion, when it purchases property for the erection of a banking house, it can use some other part of that same building for other purposes.

Mr. YINGLING. Let me address the windmill farm and Bank of America. The hotel I think is something that I understand your reaction to.

Mr. PLATTS. That and the windmill I think really jumped off the screen.

Mr. YINGLING. The windmill I think is very different, because of the tax credit aspect of it. The hotel, I think you have to go back and look at the facts. Bank of America had 72,000, this is a trillion dollar bank, one of the biggest banks in the world, growing very rapidly, they had 72,000, it says in the record, nights of employees visiting Charlotte. That doesn't include customers and partners and people they are doing deals with.

That averages out, to my calculation, to over 200 every single night. And if you assume there are not as many on the weekends, it is 300, 400, 500. It seems to me it would be understandable, it is a 150 room hotel, which is not a very big hotel. That is the minimum they could build to get somebody to agree to manage it. It would seem to me understandable that they want that in their core campus, if you will, to have people in a high-end hotel that can come and go to their offices.

But I wouldn't extrapolate from a hotel because you do have this long history, talking about——

Mr. PLATTS. Excuse me for a moment.

Mr. YINGLING. Sure.

Mr. PLATTS. I apologize for the interruption, Mr. Yingling.

Mr. YINGLING. Sorry if I filibustered. [Laughter.]

So I think the hotel comes into being based on this series of precedents about housing your people. The windmill farm is completely different. Just to give you a feel for it, the ABA, with a partner, applied to the Treasury Department for new market tax credits, and we got some of them, as did some individual banks. The idea is we distribute them to community banks, who will make the same type of deal with a not-for-profit. They will have an equity ownership, because that is the way you get the tax credit.

Mr. PLATTS. The non-profit can't get the credit.

Mr. YINGLING. Right. So these are very limited to those deals where there is a tax credit involved. And I think that is a very distinguishable event.

Mr. PLATTS. I would agree. And I think, of the three cases, I think the windmill, the way it is structured, with the tax credits and no profit from appreciation of values, is a little different, Pitts-

burgh is a little different. The hotel to me is clearly one that seems contrary to commerce.

But even the other two, especially Pittsburgh, and Ms. Shelton's testimony I thought really went to an important part of this, the risk assumed in developing these properties is that, the intent of the separation of commerce is to protect the security of the banks, the stability of the banks. And what has transpired since that 1902 case, the stock market crash, the bank closures of the 1930's, we have tried to learn from those lessons. It is a lesson of risk to banks.

And Ms. Shelton's comments really go to the risk assumption that banks are taking, the bigger the project, the more comprehensive the project. I think that is a legitimate issue that we need to be worried about, is, are banks getting into development projects that even where a part of it is for their own use, it involves a substantial risk in that marketplace versus somebody else taking the risk that the bank is helping to finance with it.

Mr. YINGLING. I understand. I would just say that size is relative. A 150 room hotel to a trillion dollar institution isn't much. You go into all these cities I was talking about around the country, you will find community banks who have taken only one story, only needed one story or one and a half stories, they have built three stories or acquired an old building and rehabbed it with three stories, they have been doing it for over 100 years. It hasn't been a problem.

Mr. PLATTS. But I think the issue is, that with Bank of America that there was a shortage of hotel rooms, and those hotels right adjacent, Marriott and Omni, weren't satisfactory. The market will fill that risk by developers taking the risk and saying, we believe there is a need here for more rooms. We will take the risk and build it. Instead, the bank says, we are going to build it and take the risk. That goes back to the issue of, is that what we want banks doing, is taking the risk versus lending money to others who take the risk. That comes back to the core issue, especially on the freestanding hotel.

Ms. SHELTON. And Chairman Platts, if I might add, if you were in Florida when all the hurricanes came through and you owned a hotel, and the occupancy rate dropped to 30 percent, the risk is phenomenal. I happen to know the hotels in the Charlotte area around the B of A, because I have been involved with the real estate investment trust in the past. I can tell you, owning a hotel with the occupancy rate that I recently looked up in Charlotte is 67 percent in the past quarter. There is room there, including B of A had agreements with some of the hotels in the surrounding area to guarantee blocks of rooms.

So now they have put in 150 hotel rooms that will compete with the same hotels that went there in the business aspect of making a profit and consumer being able to utilize it as well as the bank.

So the last piece I would leave you with is the article Tom mentioned was in the business of today is the Canyon Ranch abandons Maryland condos. They have issues that a year ago, when they gave a business plan, they wouldn't see what was going to happen to the condo market. Instead of subsidizing their bank, in fact, if they don't sell them for the projected rates, will lose money and

have to pay for it out of funds from the bank over and beyond what a selling spec would have done.

So I just think there is a lot of business aspects to it that weren't looked at.

Mr. PLATTS. That again gets to the fairness, the market aspects here of, I asked about the condos, putting 32 condos on the market, what does that do to others. And it comes to Marriott, Omni, they build hotels saying, Bank of America is here, so we are going to invest. If then Bank of America is now competing with them, the fairness in the marketplace to those who took that risk privately, aside from the banks.

I apologize, because the vote is about to close, which means I need to run. But I don't want to hold you guys here, because you would be sitting here for a while before we get the other votes in and come back. I guess if maybe I can ask one final question, and we may followup with written questions to you, if that would be OK, if there is something that we haven't covered. That might a broad question that kind of follows up where we just left off.

These rulings, Mr. Yingling, you don't see it as precedent-setting and earth shattering. Mr. Stevens, Ms. Shelton, do you see it as kind of opening the door, we are going to see more of this type of development, commercial development specifically, hotels that are going to compete with other commercial development, impact the market and therefore impact commerce?

Mr. STEVENS. I don't think you can allow or approve these three types of developments and not have it precedent setting. When the question was asked of Julie, can you guarantee that it won't, she said, well, I can't say that I won't use it in a written example in the future, or law. So yes, I think that once it is approved, it is sitting there as a precedent.

Ms. SHELTON. And I will just share, I think it will set some impact on the industry. How much, three deals, I agree, in the trillions of dollars of real estate that is out there, but the reality is, I am not talking about the trillions. I am talking about the individual investors who would have invested in those projects with small spreads to take the risk, to borrow the money from the banks, and pay it back. Now the banks are using money that they have gained from federally insured deposits that are at a lower rate. With rising interest rates, I think it will have an impact and it could open the door.

Mr. YINGLING. I would just say, to some degree we are trying to have it both ways here. Because we said, banks ought to be able to have mixed-use buildings, but when you listen to this, you are saying they can't. I would urge people to go to small towns, medium size towns, cities, and look at all those buildings that are at the cores of downtowns, and be very careful if you are saying, we are worried about the risk to the bank, we are worried about the fact that what they are leasing takes from the office building across the way. They do, but it has been that way for 100 years.

Mr. PLATTS. I think, Mr. Yingling, really what we are focusing on is, what does the law allow, is the focus. And that is what we tried to get at, to get more definitive answers, what does the law allow and what does the OCC allow in their regulations.

We are going to need to wrap up here. I very much appreciate all three of you trying to help shed light in the varying cases here, the three in particular we are looking at. We will keep the record open for anything else you want to submit, and we may followup with a written question or two to you.

Thanks for your participation. This hearing will stand adjourned.

[Whereupon, at 4:24 p.m., the subcommittee was adjourned.]

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